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**ANALYSIS ON THE CURRENT INTERPRETATIONS OF THE DUTY OF
DISCLOSURE IN ENGLISH INSURANCE AND MARINE INSURANCE
CONTRACTS**

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**A thesis submitted to the University of Bristol in
accordance with the requirements of the degree of
Doctor of Philosophy in the Faculty of Law**

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ABSTRACT

The purpose of this study is to analyze the current interpretation of the duty of disclosure which stems from the duty of utmost good faith in English insurance contracts. This peculiar feature of insurance contracts has been subject to widespread criticism over a considerable period of time for its absurdly wide range of application by the courts and insurance industry, in particular in the case of the insured's duty of disclosure. In this thesis, some of the most debatable issues in this area are singled out for discussion in detail.

Although some developments have been made in recent decisions, a lot of defects still exist in this area. Among them, the issue of the test of materiality in the case of the insured's duty of disclosure is the primary one. In particular, the questions of the standard for determining materiality and the degree of influence of the undisclosed facts in section 18(2) of the Marine Insurance Act 1906 are the core of the analysis. In addition, as to the new requirement which is the inducement of the actual insurer in order to avoid the contract for non-disclosure, an important question still remains unsolved - how to interpret the question of the presumption of inducement. Unless this question is adequately answered, the introduction of this new requirement can be meaningless.

In relation to the insurer's duty of utmost good faith, a clear answer is not provided by the courts to the questions as to the scope of the insurer's duty of disclosure and the test of materiality. This issue is also strongly related to a vexed question of whether a remedy of damages can be awarded to the injured party in the case of the insurer's breach of his duty. Although this question was eventually rejected by the higher courts, however, this issue should be reconsidered, because it is concerned with the question of the protection of the insured.

As far as the question of continuing duty of disclosure is concerned, the difference between the ambit of the post- contractual duty and that of the pre-contractual duty has not been discussed in detail in the courts or literature. Therefore, the main questions will be the analysis of the legal basis and the scope of the post-contractual duty of disclosure, along with the issue of the test of materiality of the undisclosed facts after the formation of the contract. The scope of the duty of utmost good faith in the claims process is another debatable question.

This thesis provides some possible suggestions to answer to these crucial questions, together with other important discussion on the issues of the legal basis of the duty, the time of non-disclosure at common law, the effect of the breach of the duty, and the existing reform programs including some self-regulation methods and activities of conciliation and arbitration services provided by the government and insurance industry.

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I have received a lot of assistance and encouragement from my relatives and friends, to whom I extend my grateful thanks.

My special gratitude is finally addressed to my beloved wife, Jihyun and my daughter, Hyunsun, who have always shown their great love, patience, understanding and encouragement to me.

**I hereby declare that the whole work
on which this thesis is based is my
independent work.**

SEMIN PARK

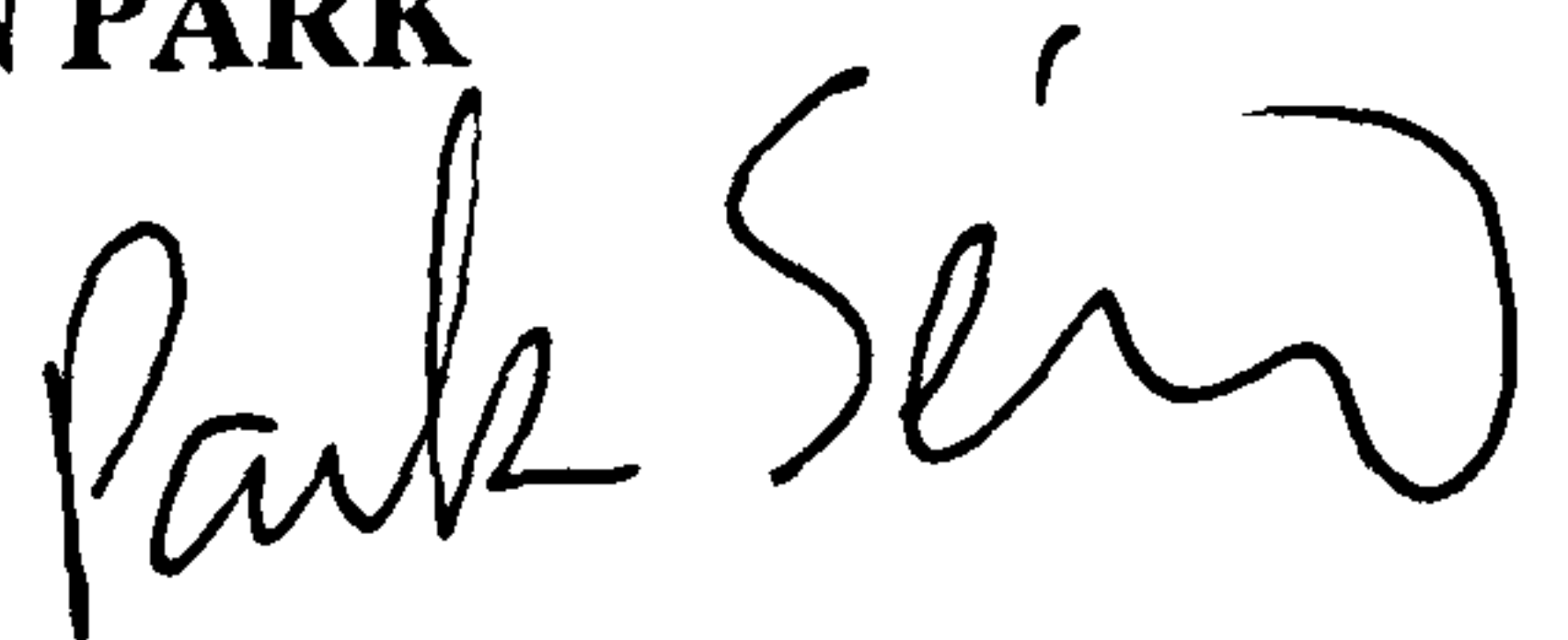
A handwritten signature in black ink, appearing to read "Park Seon", written in a cursive style.

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CHAPTER 1. INTRODUCTION

Insurance contracts are said to be *uberrimae fidei* (of the utmost good faith). The doctrine of utmost good faith in insurance contracts enjoins the contracting parties to disclose to each other voluntarily all information which would influence the other's decision to enter the contract before the contract is concluded. In other words, the parties to the insurance contracts are required to disclose to each other all facts material to the risk which are known to him but not known to the other, whether or not such information is requested. If one contracting party does not disclose them, then the aggrieved party has the right to rescind the contract. The question of whether or not the facts undisclosed are linked to the loss in question is irrelevant. These obligations are stipulated in the Marine Insurance Act 1906, which also applies to non-marine insurance.¹ Of course, contracts of surety, contracts of partnership and contracts of certain family settlement and other similar types of contractual relationship are also said to be *uberrimae fidei*, and therefore the duty of disclosure is also required in these contracts.² However, there is no doubt that insurance contracts are the best known example of it.³

No topic in insurance contract law has received more attention from the courts and literature than this duty to disclose all material facts. This is because the duty of

¹The recent decision clearly confirmed the existing view of the general application of this principle in s. 18 of the Marine Insurance Act 1906 (hereafter the M.I.A. 1906) to all kinds of insurances. See, Pan Atlantic Insurance Co. v. Pine Top Insurance Co. Ltd [1994] 3 W.L.R. 677, at p. 683.

²March Cabaret Club & Casino Ltd v. London Assurance [1975] 1 Lloyd's Rep. 169, at p. 175 ; Banque Keyser Ullman S.A. v. Skandia (U.K.) Insurance Co. Ltd [1987] 1 Lloyd's Rep. 69, at p. 93

³See, Mackenzie v. Coulson (1869) L.R. 8 Eq. 368, at p. 375 ; Greenhill v. Federal Ins. Co. [1927] 1 K.B. 65, at p. 76 ; Banque Keyser Ullman S.A. v. Skandia (U.K.) Insurance Co. Ltd [1987] 1 Lloyd's Rep. 69, at p. 93

disclosure, which stems from the duty of utmost good faith between the parties, is regarded as a peculiar feature of insurance contracts. In the general law of contract, the contracting parties are not required to reveal to each other voluntarily any information which is material to the risks before the contract is concluded. Only the principle of misrepresentation applies in ordinary commercial contracts. On the other hand, in insurance contracts, not only the principle of misrepresentation but also the additional duty of disclosure is imposed upon the parties. Hence, a contract of insurance is said to be *uberrimae fidei*. This peculiar feature of insurance contracts seems to arise from the nature of insurance contracts - mutual trust and confidence between the insurer and the insured - . This so-called fiduciary nature makes it impossible for the doctrine of *caveat emptor* to be applied in insurance contracts.⁴

The principle of duty of disclosure in English insurance contracts was first enunciated by Lord Mansfield in a marine insurance case - *Carter v. Boehm*⁵ in the eighteenth century. The main reason for adopting this principle in the case of marine insurance seems to be related to the situation of the early days of the insurance industry in which underwriters had to rely heavily on information offered by the insured in assessing the risk to be insured against. In those days, the network of collecting information or data which would be material to the risks in the marine insurance industry was underdeveloped, the underwriting skills were relatively unsophisticated and the insured was, in most cases, in a far better position to have the material information. Consequently, these circumstances required the insured's duty to disclose material facts to the insurer in the making of the contract, and the duty of disclosure had been traditionally much more incumbent on the insured rather than on the insurer even though the nature of reciprocity of this duty is recognized.

⁴It is arguable whether the relationship between the insured and the insurer can be defined as a fiduciary one. This question is eventually related with the issue of awarding damages in the insurer's breach of the duty of utmost good faith. See, Chs. 3 and 7 of this thesis.

⁵(1776) 3 Burr. 1905

The original purpose of this principle was to bring about fairness, justice, impartiality and fair dealing between both contracting parties. However, this principle has been almost unilaterally applied and interpreted in favour of the insurer only. In other words, the position of the insured has been aggravated by subsequent unjust applications and interpretations of this principle. It would appear that the scope of the duty of disclosure in relation to the insured's duty has been excessively extended beyond the original purpose of this principle, which is good faith and fair dealing between both contracting parties. In addition, this strict duty of disclosure has been almost unilaterally imposed on the insured, even in the modern insurance industry in which the situation or the position of the insurance market seems to be totally different from that of the eighteenth century.

The formidable position of the insurer has been strengthened still further by the practice of warranty - the basis of the contract. This practice of declaration at the foot of the proposal form makes all the representations on the form warranties, and the effect of this is that any inaccuracy on the form, whether material or not, innocent or fraudulent, entitles the insurer to avoid the contract in question. Consequently, the common law duty of disclosure is extended to a more stringent contractual duty of disclosure. The poor position of the insured is more apparent in relation to the issue of the test of materiality such as the standards of a prudent insurer, the practice of expert evidence and the interpretation of the words 'would', 'influence' and 'judgment' in s. 18(2) of the M.I.A. 1906.

This injustice has been admitted in the courts.⁶ In recent years, our society has gradually begun to recognize the weak position of the consumer, and consequently some social

⁶*Glicksman v. Lancashire & General Assurance Co.* [1927] A.C. 139, at pp. 143-144 ; *Provincial Insurance Co. v. Morgan* [1933] A.C. 240, at p. 252 ; *Lambert v. Co-operative Insurance Society Ltd* [1975] 2 Lloyd's Rep. 485, at p. 491 ; *Pan Atlantic Insurance Co. v. Pine Top Insurance Co.* [1993] 1 Lloyd's Rep. 496, at p. 508

legislation has been enacted. Therefore, the practical effects of utmost good faith, which had been in favour of the insurer over the years, have to some extent been modified. In addition, the Law Reform Committee 5th Report (Conditions and Exceptions in Insurance Policies, Cmnd. 62, 1957) and The Law Commission (Law Com. No. 104, Insurance Law, Non-Disclosure and Breach of warranty, 1980) have made recommendations, focusing on the harshness and poor position which the insured would have in practice as a result of the stringent duty of disclosure. These recommendations were made in order to reform the law and practice, aiming at fair dealing, justice and equality between insurers and insureds. The insurance industry responded to these governments' efforts with a form of self-regulation known as the Statements of Insurance Practice. However, the Statements of Insurance Practice issued by the Association of British Insurers are not binding upon their members. Furthermore, it would appear that those two recommendations have little changed the tendencies of the interpretation of this duty by the courts as well as the tendencies of the application of this duty by the insurance industry. These devices have their own limitations and the effects of these reforms are found to be insufficient.

The purpose of this thesis is firstly to analyze the modern principle of the duty of disclosure in English insurance contracts and secondly to criticize the tendencies of the courts and insurance industry in respect of the absurd application and interpretation of this principle. To deal with these tasks, some of the most debatable issues of this principle are singled out for discussion in detail. This thesis is composed of 10 chapters and these chapters are divided as follows.

Ch. 2 will explore the general feature of the principle including the historical analysis of *uberrima fides* in English insurance contracts. This chapter will also deal with the comparative analysis of this principle in Canada and in the U.S.A., where the scope or application of the duty of disclosure is different from that in England.

Ch. 3 will discuss the issue of the legal basis of the duty of disclosure. The question of the legal basis of the duty of disclosure - whether this duty is an implied term in a contract of insurance⁷, whether it is of a fiduciary nature or whether this duty has extra contractual effect⁸ - is a crucial issue, as this question can be linked with the range of remedies for breach of the duty of disclosure in particular the question of awarding damages.

Ch. 4 will examine the issue of the time to disclose material facts at common law. This issue will be discussed in the context of new contracts, renewal of an existing contract, and exceptional cases (life insurance, fire insurance and others).

Ch. 5 will deal with the question of the test of materiality. A material fact is one which would influence the mind of a prudent underwriter in deciding whether he will take the risk and, if so, at what premium. Among the criticisms of the range of the duty of disclosure, the criticism as to the current test of materiality has been the primary one. The test of materiality has been the subject of a certain amount of judicial disagreements such as the standard for determining materiality and the degree of influence of the undisclosed facts etc. This criticism seems to be related to the practice that materiality of a fact undisclosed is not decided by the person required to disclose it. Therefore, the main questions are who and what sort of person should be the standard of the test of materiality, and what is the exact meaning of the words, 'would' and 'influence' in s. 18(2) of the M.I.A. 1906.

⁷See, the recent cases, *Black King Shipping Co. v. Massie (The Litsion Pride)* [1985] 1 Lloyd's Rep. 437, at, pp. 518-519. ; *Bank of Nova Scotia v. Hellenic Mutual War Risks Association (Bermuda) Ltd (The Good Luck)* [1988] 1 Lloyd's Rep. 514, at p. 547.

⁸See, the recent cases, *March Cabaret Club & Casino v. London Assurance* [1975] 1 Lloyd's Rep 169, at p. 175 ; *Bauque Keyser Ullman S.A. v. Skandia (U.K.) Insurance Co. Ltd* [1987] 1 Lloyd's Rep. 69, at pp. 93-94 ; *Pan Atlantic Insurance Co. Ltd v. Pine Top Insurance Co. Ltd* [1994] 3 W.L.R. 677

Ch. 6 will analyze the new requirement to avoid the contract for non-disclosure - the element of inducement of the actual insurer. As a result of the House of Lords in Pan Atlantic Insurance Co. Ltd v. Pine Top Insurance Co. Ltd⁹, an underwriter has to show that he had actually been induced by the non-disclosure to enter into the policy on the relevant terms in order to avoid the contract for non-disclosure of a material fact. There is no doubt that this is a significant development.

However, success of this new requirement in terms of fulfilling its original purpose - the protection of the insured - largely depends on the interpretation and application of a presumption of inducement. Unfortunately, this issue was not discussed in detail in the House of Lords. This chapter will firstly discuss this issue in the general law of contract, and then will explain the rationale for the requirement of this element of inducement in insurance contracts and the vexed question of how the presumption of inducement should be interpreted in practice in insurance contracts.

Ch. 7 will discuss the nature of reciprocity of the duty of disclosure. As the statute¹⁰ and Lord Mansfield's judgment in Carter v. Boehm¹¹ make clear, this utmost good faith is required not only from the assured but also from the insurer. However, this principle of utmost good faith by the insurer hardly appeared in insurance case law until the late 1980s in England.¹² This absurdity that the duty of disclosure has been laid only upon the insured in England has been criticized by *dicta* and in the literature. Fortunately, the

⁹[1994] 3 W.L.R. 677 ; Also see, St. Paul Fire and Marine Insurance Co. (U.K.) Ltd v. McConnell Dowell Constructors Ltd (1995) 45 Construction Law Reports 89 ; Marc Rich & Co. A.G. & Another v. Peter John Portman (1995, unreported)

¹⁰S. 17. of the M.I.A. 1906

¹¹(1776) 3 Burr. 1905, at p. 1909

¹²Re Bradley and Essex & Suffolk Accident Indemnity Society [1912] 1 K.B. 415, at p. 430 and Horry v. Tate & Lyle Refineries Ltd [1982] 2 Lloyd's Rep. 416, at pp. 421-422 were the very rare examples for admitting the nature of reciprocity of this duty of disclosure before the late 1980s. ; Also, Provincial Insurance Co. v. Morgan [1933] A.C. 240, at p. 250 implied the insurer's duty of utmost good faith.

nature of reciprocity has been firmly approved in a series of recent decisions.¹³ However, there are some controversial points, for which the courts have not provided clear yardsticks, such as the scope of the duty of the insurer and the test of materiality of the facts which should be disclosed by the insurer. In addition, the question of the effect of the insurer's breach of the duty of utmost good faith is very important. In particular circumstances, it would appear that the traditional remedies - avoidance of contract and return of premium - are ineffective remedies for the insured. Under this situation, the question of awarding damages to the insured for the insurer's breach of duty should be considered, although the higher courts rejected the remedy of damages for it.

Ch. 8 will deal with the question of continuing duty of utmost good faith in insurance contracts, which has been discussed by the courts in recent cases.¹⁴ The main question will be what is the difference, if any, between the ambit of the post-contractual duty of utmost good faith and that of the pre-contractual duty of utmost good faith. The duty of utmost good faith in the claims process will be another question, along with the issue of the continuing duty of utmost good faith toward the third parties who have interests concerning the validity of the insurance policy.

¹³*Banque Keyser Ullmann S.A. v. Skandia (U.K.) Ins. Co. Ltd* [1987] 1 Lloyd's Rep. 69 ; *La Banque Financiere De La Cite S.A. v. Westgate Insurance Co.* [1988] 2 Lloyd's Rep. 513, [1990] 2 Lloyd's Rep. 377 ; *Bank of Nova Scotia v. Hellenic Mutual War Risks Associations (Bermuda) Ltd (The Good Luck)* [1988] 1 Lloyd's Rep. 514, [1989] 2 Lloyd's Rep. 238 , [1991] 2 Lloyd's Rep. 191

¹⁴*Black King Shipping Corporation v. Massie (The Litsion Pride)* [1985] 1 Lloyd's Rep. 437 ; *Continental Illinois National Bank & Trust Co. of Chicago v. Alliance Assurance Co. Ltd (The Captain Panagos)* [1986] 2 Lloyd's Rep. 470 ; *Banque Keyser Ullmann S.A. v. Skandia (U.K.) Ins. Co. Ltd* [1987] 1 Lloyd's Rep. 69 ; *Bank of Ltd*

Ch. 9 will analyze the attempted reform programs provided by the governments as regarding the unjustly wide application and harsh interpretation of the insured's duty of disclosure. The analysis will be focused on the actual effect in practice. Firstly, it will review the 5th Report from the Law Reform Committee in 1957. Secondly, the Law Commission's Working Paper No. 73 in 1979 will be analyzed. Thirdly, the proposed E.E.C. Directive in 1977, which included some interesting points which might have dramatically changed the English insurance contract law, in particular the issue of the duty of disclosure, will be examined from the government's point of view and from the principle of the protection of the insured. Among the Articles in the proposed E.E.C. Directive, the issue of the proportionality principle as to the effect of the breach of the duty seems to be instructive, compared with so-called "all-or-nothing" approach in England. Finally, the Law Commission's Final Report and Draft Bill in 1980 will be reviewed. It would appear that this Final Report comprehensively reviewed the current practice of the insured's duty of disclosure and made some useful recommendations which could mitigate the defects of this area. However, all these attempted reform by the governments failed to produce legislative response, although they have clearly shown the urgent need for reform in non-disclosure in insurance contracts.

Ch. 10 will deal with some best known forms of self-regulation such as the Statements of Practice, two complaints mechanisms for the insureds outside the courts - the Insurance Ombudsman Bureau and Personal Insurance Arbitration Services, and the Codes of Practice which regulate the aspects of insurance intermediaries. The precise understanding of these self-regulations is very important, because they are applied in everyday practice in insurance markets. Finally, summary of the suggestions for reform as to the duty of disclosure in insurance contracts will be provided as a conclusion of this thesis.

CHAPTER 2. GENERAL CONSIDERATION OF DUTY OF UTMOST GOOD FAITH

2.1. INTRODUCTION

2.1.1. GENERAL CONCEPT

In the general English law of contract, a misstatement by one party through which the other is induced to enter into the contract will entitle the latter to rescind the contract, whereas this is not usually the case with mere non-disclosure unless it amounts to any obvious misrepresentation. In other words, a contracting party generally does not have a positive duty to make a full disclosure of all material facts known to him but not to the other party. Lord Campbell expressed the view that there was no general duty to disclose in the case of a contract of sale in *Walters v. Morgan*¹, saying ;

"There being no fiduciary relation between vendor and purchaser in the negotiation, the purchaser is not bound to disclose any fact exclusively within his knowledge which might reasonably be expected to influence the price of the subject to be sold."

Lord Atkin stated in more general terms in *Bell v. Lever Brothers Ltd*² that ;

"Ordinarily the failure to disclose a material fact which might influence the mind of a prudent contractor does not give the right to avoid the contract."³

Among the justifications for this principle of English contract law, the most convincing reason would appear to be the general feature of the contracting parties trying to negotiate at arm's length in their dealings. Of course, certain safeguards such as the Sale of Goods Act 1979 and the subsequent legislation are available to purchasers, but the

¹(1861) 3 De G.F & J. 718, at pp. 723-724

²[1932] A.C. 161 at p. 227

³Also see, *Keates v. Cadogan* (1851) 10 C.B. 591 ; *Smith v. Hughes* (1871) L.R. 6 Q.B. 597 ; *Turner v. Green* [1895] 2 Ch. 205 ; *London General Omnibus Co. Ltd v. Holloway* [1912] 2 K.B. 72

common law principle which is applicable to most commercial contracts is still *caveat emptor*.⁴ However, there are some types of legal transactions and relations where the duty to disclose all material facts, which in other cases would not be imposed, is in fact required. That is to say that there are certain circumstances in which a higher degree of good faith between the parties is particularly required and the contract may be rescinded in the case of a breach of this requirement.⁵ This kind of contract which demands the duty to disclose all material facts is known as a contract of utmost good faith. As a doctrine of equity or common law, this principle, *uberrima fides*, has been applied to certain family settlement contracts such as divisions of property or agreements to vary the terms of a valid will.⁶ Contracts concerning the issue of shares in new companies,⁷ partnership⁸, and possibly suretyship⁹ also require this greater measure of good faith

⁴A maxim implying that the buyer must be cautious, as the risk is his and not that of the seller. (let the buyer beware) The rule of law as to the sale of goods is, that if a person sells them as his own, and the price is paid, and the *title* proves deficient, the seller may be compelled to refund the money. But for the *soundness* of the goods, the seller is not usually bound to answer; but there are several exceptions embodied in the Sale of Goods Act 1979.

⁵Mozley & Whiteley, *Law Dictionary*, (10th ed. by E.R. Hardy Ivamy, 1988), Butterworths, at p. 482 (hereafter Mozley & Whiteley's Law Dictionary) ; R. Colinvax, *Law of Insurance* (6th ed. by R. Merkin, 1990), Sweet & Maxwell, at p. 97 (hereafter R. Colinvax) ; MacGillivray and Parkington, *Insurance Law*, (8th ed. by M. Parkington and others, 1988), Sweet & Maxwell, at para. 634 (hereafter MacGillivray & Parkington) ; J. Birds, *Modern Insurance Law*, (3rd ed., 1993), Sweet & Maxwell, at pp. 92-93 (hereafter J. Birds) ; M. Clarke, *The Law of Insurance Contracts*, (2nd ed., 1994), Lloyd's of London Press Ltd., at pp. 549-553. (hereafter M. Clarke) ; R. Merkin and A. McGee, *Insurance Contract Law*, Kluwer Publishing, at A.5.1-01. (hereafter Merkin & McGee)

⁶*Gordon v. Gordon* (1821) 3 Swan. 400 ; *Greenwood v. Greenwood* (1863) 2 D.G. & S. 28 ; *Wales v. Wadham* [1977] 2 All E.R. 125 ; White and Tudor's *Leading Cases in Equity* vol. 1., pp. 198 ff. ; Cheshire, Fifoot & Furmston, *Law of Contract*, (12th ed. by M. Furmston, 1991), Butterworths, at p. 306 (hereafter Cheshire, Fifoot & Furmston) ; D. Allen, *Misrepresentation*, (1988), Sweet & Maxwell, at pp. 25-26 (hereafter D. Allen)

⁷*Central Rly Co. of Venezuela (Directors etc) v. Kisch* (1867) L.R. 2 H.L. 99, at p. 113 ; Some statutes such as the Protection of Depositors Act 1963, the Companies Act 1985 ss 56, 57, 66-69 and the Financial Services Act 1986 give a nature of *uberrima fides* to a contract to take shares in new companies.

⁸Partnership Act 1890 ss. 28-30. The statute impose a heavy duty of disclosure on the promoters and directors in the companies. ; Also see, Financial Services Act 1986, s. 162(1) and s. 163

with differing degrees of application.¹⁰ Among the various kinds of contracts, however, contracts of insurance have been identified as requiring the strictest application of this principle, and the principle of utmost good faith has been a fundamental tenet of insurance law. In London General Omnibus Co. Ltd v. Holloway¹¹, Kennedy L.J. said;

"No class of case occurs, to my mind, in which our law regards mere non-disclosure as a ground for invalidating the contract, except in the case of insurance. That is an exception which the law has widely made in deference to the plain exigencies of this particular and most important class of transaction".

This principle - duty of utmost good faith - was stated by Lord Mansfield in Carter v. Boehm¹² more than two hundreds years ago, and his seminal judgment has been regarded as one of the best statements on this issue throughout all the common law jurisdictions. The lucid explanation by Lord Mansfield as to this doctrine is still regularly cited. A full examination and analysis of Lord Mansfield's judgment on this issue is undoubtedly essential to understand this doctrine, as this analysis might throw new light on the tendency of the current unbalanced and unjust judgments on this principle in the courts.¹³

2.1.2. NECESSITY OF THIS DUTY FROM MARINE INSURANCE

⁹See, National Provincial Bank of England Ltd v. Glamusk [1913] 3 K.B. 335, at p. 338, which required a duty of disclosure of unusual circumstances which were known to the creditor and the surety would not expect in the normal circumstances.

¹⁰Banque Keyser Ullmann S.A. v. Skandia (U.K.) Insurance Co, Ltd [1987] 1 Lloyd's Rep. 69, at p. 93 ; March Cabaret v. London Assurance [1975] 1 Lloyd's Rep. 169, at p. 175 ; Cheshire, Fifoot & Furmston, at pp. 302-307. ; *Chitty on Contracts*, Vol. 1 (26th ed. by A. Guest and others, 1989), Sweet & Maxwell, para. 481 (hereafter Chitty) ; H. Yeo, "Of reciprocity and remedies - duty of disclosure in insurance contracts", (1991) 11 Legal Studies 131.

¹¹[1912] 2 K.B. 72, at pp. 85-86 ; Also see, Mackenzie v. Coulson (1869) L.R. 8 Eq. 368, at p. 375 ; Greenhill v. Federal Ins. Co. [1927] 1 K.B. 65, at p. 76, where held that insurance was a contract of the utmost good faith, and it was of importance to commerce that position should be observed.

¹²(1776) 3 Burr. 1905.

¹³The analysis of Lord Mansfield's judgment will be discussed in the Historical Background section (2.2.) of this chapter.

This nature of utmost good faith in insurance contracts seems to have been brought about as a natural result from the original process of underwriting marine insurance which was the first type of insurance in insurance history. That is to say, the practice of submitting a slip describing the proposed risk by an applicant to the different underwriters, in many cases, excluded the inspection of the proposed risk by the insurer and made the insurer entirely rely on what the insured described when the insurer decided whether he would take the risk and, if so, at what rate of premium. Accordingly, the insured in marine insurance contracts had to fully and fairly divulge material information to the insurer.

This kind of process in which a higher degree of good faith was required of a contracting party was mainly caused by the disparity regarding the parties' knowledge and positions in marine insurance as Lord Mansfield pointed out.¹⁴ Scrutton L.J. expressed this point in *Greenhill v. Federal Ins. Co.*¹⁵ ;

"Insurance is a contract of the utmost good faith... The underwriter knows nothing of the particular circumstances of the voyage to be insured. The assured knows a great deal, and it is the duty of the assured to inform the underwriter of everything that he is not taken as knowing, so that the contract may be entered into on an equal footing."

This disparity as to the parties' knowledge in relation to the risk insured against can be also found in general insurance contracts. That is to say, contracts of insurance are mostly based on facts which are, in many cases, in the exclusive knowledge of the insured. Therefore, unless that knowledge is passed on to the insurer, the actual risk insured against may be different from that originally intended to be covered by insurer. Therefore, the duty of disclosure which stems from the duty of utmost good faith is strongly required in insurance contracts.

¹⁴*Carter v. Boehm* (1776) 3 Burr. 1905, at pp. 1909-1910

¹⁵[1927] 1 K.B. 65, at p. 76.

2.1.3. BRIEF ACCOUNTS OF CONTENTS OF THIS PRINCIPLE

2.1.3.1. RECIPROCITY & MATERIALITY

The duty of disclosure in insurance contracts means that a party to a proposed contract is obliged to reveal to the other party all material facts which would influence the other's decision to enter the contract, whether such facts are requested or not. It is clear that the duty of disclosure is imposed not only on the insured but also on the insurer from s. 17 of the M.I.A. 1906 and Lord Mansfield's judgment in *Carter v. Boehm*.¹⁶ In s. 18 of the M.I.A. 1906, the insured's duty of disclosure requires that the insured should disclose every circumstance which would influence the judgment of a prudent insurer in the relevant type of insurance in fixing the premium or determining whether to take the risk. As far as the insurer's duty is concerned, the recent case held that he should disclose to the insured a fact which is relevant to the nature of the risk sought to be covered, or to the recoverability of a claim under the policy which a prudent insured would take into account in deciding whether or not to place the risk with the proposed insurer.¹⁷ However, this nature of reciprocity had hardly appeared in practice, and this duty had been unilaterally imposed upon the insured only until the late 1980s.¹⁸

2.1.3.2. SCOPE OF DUTY

This duty of disclosure is limited to those facts which one party knows or ought to know, i.e., the duty of disclosure extends only to facts which are within the knowledge

¹⁶(1776) 3 Burr. 1905, at pp. 1909-1910

¹⁷*La Banque Financiere de la Cite S.A. v. Westgate Insurance Co.* [1988] 2 Lloyd's Rep. 513, at pp. 544-545 ; [1990] 2 Lloyd's Rep. 377, at pp. 380, 381 and 388 (cf. Lord Jauncey's view, at p. 389)

¹⁸*Banque Keyser Ullman S.A. v. Skandia (U.K.) Insurance Co. Ltd* [1987] 1 Lloyd's Rep. 69, at p. 93, [1988] 2 Lloyd's Rep. 513, at pp. 543-546, [1990] 2 Lloyd's Rep. 377, at p. 380 ; *Bank of Nova Scotia v. Hellenic Mutual War Risks Association (Bermuda) Ltd (The Good Luck)* [1988] 1 Lloyd's Rep. 514, at pp. 545-547 [1989] 2 Lloyd's Rep. 238, at pp. 263-265. As to the general test of materiality, see, Ch. 5 of this thesis. As to the principle of reciprocity and the test of materiality in insurer's duty of disclosure, see, Ch. 7 of this thesis.

of one party but not within the knowledge of the other party. In the case of insured's duty to disclose, if the insured's brokers are aware of material facts or ought to know them, their knowledge is deemed to be that of the insured.¹⁹ At common law, a person cannot be blamed for not disclosing facts which he does not know and which he cannot reasonably be expected to know.

For instance, if a person is unknowingly afflicted with a stomach tumour, which was the direct reason for his death shortly after effecting a life insurance policy, the insurers cannot avoid their liability on the grounds that the existence of the tumour was not disclosed. However, in insurance contract, the insurers would be able to repudiate the policy, if it can be proved that a reasonable man should and could have ascertained this serious position.

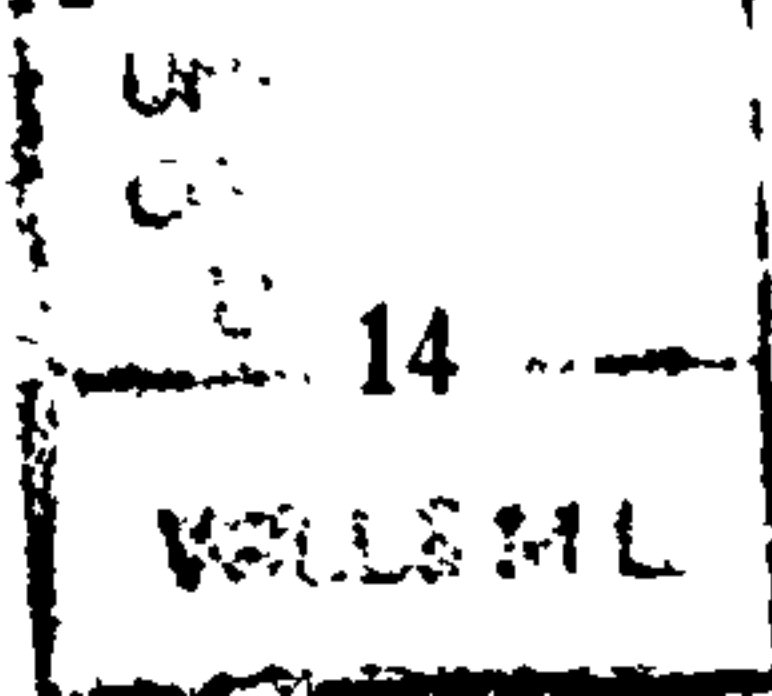
It is not necessary to disclose facts which are known or ought to be known to the other party, and, similarly, which reduce the risk. In other words, the insured need not disclose facts which are either known to the insurer, or presumed to be known to him as matters of common notoriety or knowledge or which an insurer ought to know in the ordinary course of business.²⁰ In addition, if a party does not ask specific questions after disclosure of facts have put him on inquiry, he may be regarded to have waived the right to disclosure of the facts.²¹ However, these exceptions are not applicable in case that the facts are so unusual and unpredictable.

2.1.3.3. EFFECT OF NON-DISCLOSURE

¹⁹S. 19(1) of the M.I.A. 1906 ; Blackburn, Low & Co. v. Vigors (1887) 12 App. Cas. 531

²⁰S. 18 (3)(a)(b) of the M.I.A. 1906 ; Carter v. Boehm (1776) 3 Burr. 1905 ; Foley v. Tabor (1861) 2 F. & F. 663 ; Bates v. Hewitt (1867) L.R. 2 Q.B. 595

²¹S. 18 (3)(c) of the M.I.A. 1906 ; Ayrey v. British Legal and United Provident Assurance Co. [1918] 1 K.B. 136 ; Becker v. Marshall (1922) 12 Ll.L.R. 413 ; Greenhill v. Federal Insurance [1927] 1 K.B. 65



A failure to disclose material facts gives the aggrieved party the right to regard the contract as void.²² In other words, a failure to disclose entitles the aggrieved party to avoid the contract *ab initio*, and upon avoidance it is deemed never to have existed.²³ Therefore, on avoidance of the contract, the insured is entitled to full restitution of his premium, which has been already paid to the insurer, on the basis of total failure of consideration²⁴, and the insurer is entitled to refuse to pay claims, and to demand repayment of any claims paid. The insured's right of restitution can be restricted. Firstly, in the case of the existence of fraud in insured's breach of the duty of disclosure, the premium will be forfeited to the insurer.²⁵ Secondly, where the policy provides that the premium is not to be recoverable if the policy is avoided, this type of clause has been held to be valid.²⁶ However, in the latter case, it might cause conceptual problems in that its existence is owed to a policy which has, by definition, ceased to exist. In addition, the Insurance Ombudsman is not likely to allow the enforcement of this clause unless its existence and effect have been brought to the insured's attention before the contract is made between the insured and the insurer.²⁷

Where a policy has been obtained as a result of the insured's breach of duty, and has been renewed, it would appear that the insurer is entitled to avoid the original contract as well as all subsequent renewals.²⁸ As clearly stated in the relevant sections in the M.I.A. 1906, the effect of non-disclosure is to make the contract voidable (not void),

²²Sections 17 and 18 of the M.I.A. 1906

²³For example, *Cornhill Insurance Co. v. Assenheim* (1937) 58 Ll.L.R. 27, at p. 31 ; *Black King Shipping Corporation v. Massie (The Litsion Pride)* [1985] 1 Lloyd's Rep. 437, at p. 515

²⁴*West v. National Motor and Accident Insurance Union* [1955] 1 All E.R. 800

²⁵S. 84(1) of the M.I.A. 1906.

²⁶*Broad & Montague Ltd v. South East Lancashire Insurance Co. Ltd* (1931) 40 Ll.L.R. 328

²⁷Merkin & McGee, A.5.6-01

²⁸Insurance Ombudsman Bureau Annual Report 1993, at para. 6.69

therefore the aggrieved party has an option whether or not to avoid the contract for the breach of the duty.²⁹ Therefore, the contract remains in force unless and until it has been avoided.

The aggrieved party must avoid the contract within a reasonable time of becoming aware of the non-disclosure, if avoidance is his wish. It is because some aggrieved party's subsequent conduct, which seems to be inconsistent with his original intention to avoid the policy, such as accepting further premium, paying an his opponent's claim or investigating the insured's claim without any express reservation of rights, may be regarded as an affirmation of the contract, and his right to avoid the contract will be lost. (waiver) However, in McCormick v. National Motor and Accident Insurance Union³⁰, it was held that a mere short period of delay by the insurer in deciding whether or not the policy is to be avoided for breach of the duty of disclosure would not sufficient to amount to waiver.

Of course, if the insurer expressly affirms the policy in question, his right to avoid is lost. In addition, once the aggrieved party has chosen his option, it is irrevocable.³¹ It should be remembered that the insurer is entitled to avoid the contract whether or not the facts undisclosed contribute to the loss in question. The duty of disclosure is, thus, strict in nature. It would appear that the insurer's right to rescind the contract *ab initio* for non-disclosure of material fact is unjust and inappropriate, because it is possible for the insurer to avoid the whole policy for non-disclosure of a fact which may have only a marginal effect on a higher premium, or is totally unconnected with the loss.³² The

²⁹Mackender v. Feldia A.G. [1967] 2 Q.B. 590

³⁰(1934) 49 Ll.L.R. 361

³¹Clough v. London & N.W.Ry. (1871) L.R. 7 Ex. 26

³²However, the latter case might be modified by the Statements of Insurance Practice.

effect of non-disclosure has been criticised by Donald Nicholls V.C. in the Court of Appeal in Pan Atlantic Insurance Co. Ltd v. Pine Top Insurance Co. Ltd³³ :

"Justice and fairness would suggest that when the inadvertent non-disclosure came to light what was required was an adjustment in the premium or, perhaps, in the amount of the cover. Those are not options available under English law. The remedy is all or nothing. The contract of insurance is avoided altogether, or it stands in its entirety. This is not the only field in which English law still seems to adopt an all-or-nothing approach, when what is needed is a more sophisticated remedy more appropriate, and in that sense more proportionate to the wrong suffered."

Although the recent decision of the House of Lords in Pan Atlantic Insurance Co. Ltd v. Pine Top Insurance Co. Ltd might go some way to resolving the injustice that has surrounded non-disclosure in insurance contracts by introducing the requirement of actual inducement,³⁴ this decision did not resolve the unfairness of the right to rescind, i.e., 'all or nothing' approach itself. The Law Commission, who discussed the issue of the 'all or nothing' approach which has produced great injustice, rejected the possible solution to this unfairness - a principle of proportionality³⁵, which was adopted by the proposed E.E.C. Directive in 1977.³⁶

This principle of proportionality means that where the insured inadvertently breached his duty, the insurer is obliged to pay the proportion of the loss represented by the proportion of the premium actually paid. This principle was supported by the Insurance Ombudsman's 1989 Report and commonly adopted in Continental jurisdictions. In fact, no reform as to the unfairness of the right to rescind caused by 'all-or-nothing approach' has been made so far in English insurance law.

³³[1993] 1 Lloyd's Rep. 496, at p. 508

³⁴However, its success largely depends on the interpretation and application of the presumption of inducement in practice. For more detailed discussion, see Chapter 6.

³⁵A Working Paper No. 73 (1979). Also see, A Final Report No. 104 (1980) Cmnd 8064

³⁶This proposal was abandoned in 1993.

An action for damages for non-disclosure is not stipulated in the wordings of ss. 17-18 of the M.I.A. 1906 nor is allowed in the recent judgments³⁷, because it is more widely recognized that the duty of disclosure is a rule of law, not an implied contractual term. At common law, it is difficult to find a case in which the insurer is more keen on the remedy of damages instead of the remedy of rescission of the policy in question for the insured's breach of the duty of utmost good faith, because the remedy of rescission of the policy and the retaining of premium, if permitted to do so, will be the most effective remedies in most cases. Not surprisingly, it had been assumed that the insurer has no right to damages, and it was held recently that damages were never available for a breach of the duty of utmost good faith.

Section 2(2) of the Misrepresentation Act 1967 provides that the remedy of damages could be awarded instead of the remedy of rescission. The purpose of this provision is undoubtedly to avoid the possible harshness which the remedy of rescission could produce. This provision could be applied in the case where the insurer seeks to avoid the policy for an innocent misrepresentation which is not related to the insured's loss. However, it has a limited application in the insurance context, because it provides the remedy in the case of positive misrepresentation and does not apply to non-disclosure. As to the interpretation of this provision, in consumer insurance cases this provision could be applied in practice³⁸, whereas it was held by Steyn J. in Highland Insurance Co. v. Continental Insurance Co.³⁹ that in commercial insurance cases, the remedy of

³⁷La Banque Financiere de la Cite S.A. v. Westgate Insurance Co. [1988] 2 Lloyd's Rep. 513, [1990] 2 Lloyd's Rep. 377 ; Bank of Nova Scotia v. Hellenic Mutual War Risks Association (Bermuda) Ltd (The Good Luck) [1989] 2 Lloyd's Rep. 238, [1991] 2 Lloyd's Rep. 191 ; However, a deliberate concealment of a fact known to be material may constitute fraud, and an action for damages may be available. See, Dalglisch v. Jarvie (1850) 2 Mac. & G. 231

³⁸The Insurance Ombudsman Bureau Annual Report 1990 at pp. 7-8

³⁹[1987] 1 Lloyd's Rep. 109

rescission should be still available, even in the above situation (an innocent misrepresentation).⁴⁰

The issue of awarding damages is much more important in the case where the insurer breaches the duty of utmost good faith, and the remedy of damages seems to be the only effective remedy to the insured. Although it was held that the remedy of damages was not allowed even in this situation, however, some theories in relation to tort and a fiduciary relationship or quasi-fiduciary nature of insurance contracts has been recently developed to find any possibility for awarding damages.⁴¹

2.1.4. CONSTRUCTIVE KNOWLEDGE IN INSURED'S DUTY OF DISCLOSURE⁴²

2.1.4.1. MARINE INSURANCE CASE

It is very clear that constructive knowledge is included in the scope of the insured's duty of disclosure in marine insurance cases. S. 18(1) of the M.I.A. 1906 states that "... the assured is deemed to know every circumstance which in the ordinary course of business, ought to be known by him."⁴³ Therefore, if an applicant for a marine insurance policy ought, in the ordinary course of his business, to have knowledge of material facts to the proposed risk before the contract is concluded, he will be treated as having known those facts in relation to the issue of non-disclosure. Therefore, the insured's duty to disclose would include the facts of which he is actually unaware.

2.1.4.2. NON-MARINE INSURANCE CASES

⁴⁰Merkin & McGee, at A.5.6-03

⁴¹For more detailed discussion, see, Ch. 7 of this thesis.

⁴²As to the question of constructive knowledge in insurer's duty of disclosure, see, Ch. 7 of this thesis.

⁴³Also see, *Proudfoot v. Montefiore* (1867) L.R. 2 Q.B. 511

On the other hands, in non-marine insurance cases in relation to the insured's duty, the question of whether constructive knowledge is to be imputed to the insured remains uncertain and is an open matter.⁴⁴ In March Cabaret Club v. London Assurance⁴⁵, May J. held that there was no justifiable reason for distinguishing between marine and non-marine insurance. Some cases insisted that the law on non-disclosure should be identical for marine and non-marine insurance, as the M.I.A. 1906 is said to be the codification of the common law rules in respect of all classes of insurance.⁴⁶ According to this view, a proposer is surely under a duty to disclose what he constructively knows in all kinds of insurance.

However, from the general commercial law's point of view, the doctrine of constructive knowledge does not seem to be applicable in non-marine insurance cases. For example, Lindley L.J. said in Manchester Trust v. Furness⁴⁷ that ;

"... if we were to extend the doctrine of constructive notice to commercial transactions we should be doing infinite mischief and paralyzing the trade of the country."

Moreover, some decisions made it clear that s. 18(1) of the M.I.A. 1906 need not necessarily be the same to non-marine insurance cases, although the Act is the codification of the common law.⁴⁸ Furthermore, in Australia and New Zealand Bank v.

⁴⁴Australia and New Zealand Bank v. Colonial and Eagle Wharves Ltd [1960] 2 Lloyd's Rep. 241, at pp. 251-252

⁴⁵[1975] 1 Lloyd's Rep. 169, at p. 174

⁴⁶Cantiere Meccanico Brindisino v. Janson [1912] 3 K.B. 452, at p. 467 ; Locker & Woolf v. W. Australian Insurance Co. [1936] 1 K.B. 408, at p. 415 ; Highlands Insurance Co. v. Continental Insurance Co. [1987] 1 Lloyd's Rep. 109, at pp. 113-114

⁴⁷[1895] 2 Q.B. 539, at p. 545 ; Also see, Newsholme Brothers v. Road Transport & General Insurance Co. [1929] 2 K.B. 356, at p. 374

⁴⁸Yorke v. Yorkshire Insurance [1918] 1 K.B. 662 ; Regina Fur v. Bossom [1957] 2 Lloyd's Rep. 466

Colonial and Eagle Wharves Ltd.⁴⁹, McNair J. left open even the question of whether s. 18(1) of the M.I.A. 1906 represented the common law rule. In life insurance cases, in particular, the focus has always been placed on what the assured *actually* knows. Fletcher Moulton L.J. emphasized in a life insurance case, Joel v. Law Union and Crown Insurance Co.⁵⁰, that there was no duty to disclose what the proposer did not know, saying that ;

"The duty is a duty to disclose, and you cannot disclose what you do not know. The obligation to disclose, therefore, necessarily depends on the knowledge you possess.... But the question always is: Was the knowledge you possess such that you ought to have disclosed it? Let me take an example. I will suppose that a man, as is the case with most of us, occasionally had a headache. It may be that a particular one of these headaches would have told a brain specialist of hidden mischief. But to the man it was an ordinary headache indistinguishable from the rest. Now, no reasonable man would deem it material to tell an insurance company of all the casual headaches he had had in his life, and , if he knew no more as to this particular headache than that it was an ordinary casual headache, there would be no breach of his duty towards the insurance company in not disclosing it. He possessed no knowledge that it was incumbent on him to disclose, because he knew of nothing which a reasonable man would deem material, or of a character to influence the insurers in their action."⁵¹

In addition, the words of the section, with their reference to "the ordinary course of business" seems to be unsuitable to cover the person placing of a motor, household or accident policy by an individual assured.⁵² Considering the historical and practical background between marine insurance and non-marine insurance along with the above reasons, the better view seems that constructive knowledge ought not to be imputed to the insured in relation to the scope of the insured's duty of disclosure in non-marine insurance contracts. However, if his ignorance is due to fraud (intentional failure) or due to the considerable lack of *uberrima fides*, it could be a breach of the duty of disclosure.

2.1.5. GENERAL APPLICATION OF S. 18 OF M.I.A. 1906

⁴⁹[1960] 2 Lloyd's Rep. 241, at p. 252

⁵⁰[1908] 2 K.B. 863, at pp. 884-885

⁵¹Also see, Swete v. Fairlie (1833) 6 C. & P. 1 ; Fowkes v. Manchester and London Life Insurance Co. (1862) 3 F. & F. 440

⁵²MacGillivray & Parkington, at para. 640

There is no doubt that this principle of the duty of disclosure applies to all kinds of insurance, although the duty of disclosure is stipulated in the M.I.A. 1906. The following examples clearly show that this doctrine applies to all species of insurance. In Lindenau v. Desborough⁵³, Bayley J. stated the general applicability of this principle ;

"I think that in all cases of insurance, whether on ships, houses, or lives, the underwriter should be informed of every material circumstance within the knowledge of the assured; and that the proper question is, whether any particular circumstance was in fact material? and not whether the party believed it to be so."

Rozanes v. Bowen⁵⁴ also illustrated this very clearly ;

"It has been for centuries in England the law in connection with insurance of all sorts, marine, fire, life, guarantee and every kind of policy, that as the underwriter knows nothing and the man who comes to him to ask him to insure knows everything, it is the duty of the assured, the man who desires to have a policy, to make a full disclosure to the underwriters without being asked of all the material circumstances, because the underwriter knows nothing and the assured knows everything. That is expressed by saying that it is a contract of the utmost good faith - *uberrima fides*"

This general application of this principle was confirmed again by the House of Lords in Pan Atlantic Insurance Co. v. Pine Top Insurance Co. Ltd.⁵⁵ Lord Mustill said in this case ;

"Although the issues arise under a policy of non-marine insurance it is convenient to state them by reference to the Marine Insurance Act 1906 since it has been accepted in argument, and is indeed laid down in several authorities, that in relevant respects the common law relating to the two types of insurance is the same, and that the Act embodies a partial codification of the common law."⁵⁶

⁵³(1828) 8 B. & C. 586, at p. 592

⁵⁴(1928) 32 Ll.L.R. 98, at p. 102

⁵⁵[1994] 3 W.L.R. 677, at p. 683

⁵⁶Also see, Godfrey v. Britannic Assurance Co. Ltd [1963] 2 Lloyd's Rep. 515, at p. 528 ; Babatsikos v. Car Owners' Mutual Insurance Co. Ltd [1970] 2 Lloyd's Rep. 314, at p. 325 ; March Cabaret Club & Casino Ltd v. London Assurance [1975] 1 Lloyd's Rep. 169, at p. 174 ; Lambert v. Cooperative Insurance Sy. Ltd [1975] 2 Lloyd's Rep. 485, at pp. 487 and 493 ; Highlands Insurance Co. v. Continental Insurance Co. [1987] 1 Lloyd's Rep. 109, at pp. 113-114

However, it would appear that the 'general application of the duty of disclosure' does not necessarily mean that the application and the extent of this duty, such as the materiality of the fact, the knowledge of the fact, and the relationship between the aspect of disclosure by inquiry and that by voluntariness, are the same in every type of insurance.⁵⁷

2.1.6. RELATIONSHIP BETWEEN MISREPRESENTATION AND NON-DISCLOSURE

It would appear that the relationship between the two duties is a closely related one as a breach of one duty may be related to a breach of the other duty. In other words, a non-disclosure of a material fact by one party may be regarded as his implied representation that he has nothing to disclose to the other party. On the other hand, a misrepresentation concerning a fact may be also treated as a non-disclosure of the fact, provided the insured knows the fact in question. Considering these co-relationships and the similar scope between the two duties, an insurer may be able to repudiate the policy in practice, relying on either duty, in the case of a breach by the insured.⁵⁸

2.1.7. FIDUCIARY RELATIONSHIP

Under certain circumstances where the relationship between the parties is of a confidential or fiduciary nature, a duty to disclose a material fact may arise and its non-disclosure may have the same effect as a representation of its non-existence. In other words, the duty of disclosure is required from the point of view of the concept of equity because of the special relationship between the parties, and full disclosure of a material

⁵⁷MacGillivray & Parkington, at para. 636

⁵⁸See, D. Kelly & M. Ball, *Principles of Insurance Law in Australia and New Zealand*, (1991), Butterworths, Sydney, at pp. 52-53 (hereafter Kelly & Ball)

fact is sufficient to fulfill the duty. Where there is a relationship to which the doctrine of undue influence applies such as trustee and beneficiary, the duty may be more extensive.⁵⁹ As to this nature of relationship, Lord Chelmsford stated in Tate v. Williamson⁶⁰ ;

"Wherever two persons stand in such a relation that, while it continues, confidence is necessarily reposed by one, and the influence which naturally grows out of that confidence is possessed by the other, and this confidence is abused, or the influence is exerted to obtain an advantage at the expense of the confiding party, the person so availing himself of his position will not be permitted to retain the advantage, although the transaction could not have been impeached if no such confidential relation had existed."

There are several examples of this kind of relationship: trustee and beneficiary, principal and agent, partners, parent and child, and solicitor and client etc.. However, it would appear that the term of fiduciary relation is very comprehensive and used in a very loose sense.⁶¹ In addition, it is clear that the categories of fiduciary relationship should not be regarded as being closed.⁶²

However, although a contract between the parties who have a fiduciary relationship imposes a duty to disclose a material fact on them, the reason which requires this duty may be different from insurance contracts which have been regarded as contracts *uberrima fidei*. The duty of disclosure in a fiduciary relationship is required from the point of view of the equity of the special relationship of confidence, whereas the duty in an insurance contract arises from an imbalance in the information.⁶³

⁵⁹Sealy, "Fiduciary Relationships", (1962) Cambridge L.J. 69 ; "Some Principles of Fiduciary Obligation", (1963) Cambridge L.J. 119 ; G. Treitel, *The Law of Contract*, (8th ed., 1991), Sweet & Maxwell/Stevens, at p. 358 (hereafter G. Treitel) ; Cheshire, Fifoot & Furmston, at pp. 307-308

⁶⁰(1866) L.R. 2 Ch. App. 55, at p. 61

⁶¹Re Reading's Petition of Right [1949] 2 All E.R. 68, at p. 70

⁶²English v. Dedham Vale Properties Ltd. [1978] 1 W.L.R. 93, at p. 110

⁶³W. Anson, *Law of contract*, (26th ed. by A. Guest, 1984), Oxford, at p. 231 (hereafter Anson) ; M. Clarke, at p. 550

2.1.8. MISCELLANY

The word 'non-disclosure' is sometimes replaced by the word 'concealment' in order to express a failure on the part of the insured to disclose a material fact.⁶⁴ It would appear that the word 'concealment' implies the withholding or suppression of something material which is the object of the duty of disclosure. This word does not seem to be appropriate for the cases where the failure to disclose was made by the insured with no intention. In other words, it seems to be difficult for this word to be applied to the case of an inadvertent omission. Therefore, the use of the word 'non-disclosure' seems more appropriate in the context of English law.

2.2. HISTORICAL BACKGROUND

2.2.1. INTRODUCTION

There is no doubt about the existence of the principle of the duty of utmost good faith itself in insurance contracts. It has been said that the modern doctrine of *uberrima fides* in a contract of insurance originated in Roman law. This Roman principle, which had been developed under the continental civil law, in particular in Italian city-states, came into English law, and became a part of English common law. In the eighteenth centuries, the principle of *uberrima fides* in English insurance law was recognized by Lord Mansfield in Carter v. Boehm⁶⁵, and it has been widely accepted since then as a fundamental principle in insurance contracts.

In other words, the doctrine of good faith already existed in English common law before this decision was made, and Lord Mansfield clearly expressed a view of the applicability of this principle in English insurance contracts. The effect of the judgment

⁶⁴London Assurance v. Mansel (1879) 11 Ch. D. 363, at p. 370 ; Asfar & Co. v. Blundell [1896] 1 Q.B. 123, at p. 129

⁶⁵(1776) 3 Burr. 1905.

of this case has directly or indirectly influenced the courts in the U.S.A., Canada, New Zealand and Australia etc.. However, the current application or development of this principle in these countries seems to be different from those in England.

It would appear that the study of the historical background of this duty of disclosure is very useful in tracing the original intention and the scope of this principle. The comparison between the original principle and the current application of this principle clearly shows how much, and in what way this doctrine, as stated by Lord Mansfield in the leading case of *Carter v. Boehm*, has been changed by the English courts.⁶⁶ This analysis will also give a valuable guideline for the reform of the current practice of this duty of disclosure in the insurance markets as well as in the courts, which seems to go against the original intention of this principle - fair dealing and impartiality -.

2.2.2. HISTORY OF PRINCIPLE OF GOOD FAITH⁶⁷

2.2.2.1. ROMAN LAW

The principle of good faith originated in Roman law. According to the Roman law principle, the duty of good faith was required in all cases of contracts, and the concealment of any material facts of which the other party was ignorant was prohibited. Under this principle, any breach of this duty entitled the aggrieved party to a rescission of the contract. Some similarities are found between the current doctrine of *uberrima fides* in English insurance contracts and the Roman concept of utmost good faith in

⁶⁶See, Lord Chorley, "Liberal Trends in Present-Day Commercial Law", (1940) 3 Modern Law Review 272 (hereafter M.L.R.) ; R. Hasson, "The Doctrine of Uberrima Fides in Insurance Law - A Critical Evaluation -", (1969) 32 M.L.R. 615

⁶⁷Buckland and McNair, *Roman Law & Common Law : A Comparison in Outline*, (1936), Cambridge Univ. Press ; C. Fifoot, *History and Source of the Common law: Tort and Contract*, (1949), Stevens & Sons Ltd. ; J. Ames, *Lectures on legal history and miscellaneous legal essays*, (1922), Harvard Univ. Press ; S. Stoljar, *A History of Contract at Common Law*, (1975), Australian National Univ. Press ; R. Davis, "The Origin of Duty of disclosure under Insurance Law", (1991) 4 Insurance Law Journal 71, at pp. 74-80 (hereafter Ins. L.J.) ; R. Powell, "Good Faith in Contracts", (1956) 9 Current Legal Problems 16 at pp. 17-25 (hereafter C.L.P)

contracts. Firstly, there is no requirement for the proof of fraudulent intent in claiming a breach of this duty. Secondly, there is no need to prove that non-disclosure of a material fact had actually induced a particular party (insurer) to enter into the contract.⁶⁸ Thirdly, the existence of a fiduciary relationship between the parties is not necessary for allowing the remedy.⁶⁹ Lastly, the remedy for a breach of this principle is very similar.

2.2.2.2. ENGLISH COMMON LAW⁷⁰

It has been said that the principle of utmost good faith in English common law is an offspring of the Roman law concept. In England, the notion of good faith often appeared in petitions to the King, which were inevitable outcomes caused by the inadequate remedies for breach of a contract as well as the limitations on the jurisdiction of the common law courts over contracts.⁷¹ The petitioner frequently made the plea, saying that "the debtor had performed against good faith and conscience", and the Chancellor, who was actually in charge of dealing with this petition, laid stress on this principle of the duty of good faith in handling this petition.⁷²

How and in what ways was the civil law concept of utmost good faith introduced into the English common law? In England, the Court of Admiralty which was in charge of civil law and procedure initially had jurisdiction over insurance matters. This Court of Admiralty, however, did not have jurisdiction over disputes between English people

⁶⁸However, the inducement of the particular insurer by non-disclosure in making of a contract is now required by a recent decision. See, *Pan Atlantic Insurance Co. v. Pine Top Insurance Co.* [1994] 3 W.L.R. 677, at pp. 711-712 and 732

⁶⁹R. Davis, *Ibid.*, at pp. 74-75

⁷⁰W. Holdsworths, *A History of English Law*, Vol.III & VIII (1966), Sweet & Maxwell ; Baker and Milsom, *Sources of English Legal History*, (1986) ; A. Manchester, *Sources of English Legal History 1750-1950*, (1984), Butterworths

⁷¹R. Powell, *Ibid.*, p. 22 ; Cheshire, Fifoot and Furmston, at pp. 1-5

⁷²F. Maitland, *Equity - A Course of Lectures-*, (revised by J. Brunyate, 1949), Cambridge University Press, at pp. 1-11.

where there was no maritime factor, because its jurisdiction was confined to cases in which a foreigner was a party or where there was some maritime element. Along with this restriction, in the fifteenth and sixteenth centuries, the courts of the fair, whose role was very important in the Court of Admiralty, disappeared as a result of the development and growth of the central courts.⁷³

In the sixteenth century, commercial trade with the Italian city-states, where the old Roman law concept of good faith between the contracting parties had a great influence on commercial law and practice including marine insurance, had increased.⁷⁴ In the meantime, the common law courts had obtained jurisdiction over mercantile matters including insurance, and common law had a form of action for general breach of promise and a general remedy for breach of contract through the action of *assumpsit*⁷⁵ which had been developed through a series of cases such as Skyrne v. Butolf⁷⁶, Watton v. Brinth⁷⁷, Pickering v. Thoroughgood⁷⁸ and Slade's Case⁷⁹. This new device - an action of *assumpsit*- which superseded the old forms of action, particularly debt *sur*

⁷³In the development of English common law, the period of the end of the Middle Ages was a landmark in terms of establishing royal courts by which many local tribal customs were combined into one body of law.

⁷⁴David and Brierley, *Major Legal Systems in the World Today*, (3rd ed., 1985), at pp. 311-314 ; R. Davis, *Ibid.*, at pp. 76-77

⁷⁵A voluntary promise, by which a person, for a consideration, *assumed* and took on himself to perform to pay anything to another. This word now is chiefly applied to the action which lay where a party claimed damages for breach of *simple contract*, i.e., a promise not under seal. See, Mozley & Whiteley's Law Dictionary, at p. 37 ; C. Fifoot, *Ibid.*, chs. 13-15

⁷⁶YB 2 Ric. 2 (Ames Series) 223 Carter v. Boehm (1776) 3 Burr. 1905, at p. 1909 ; London Assurance v. Mansel (1879) 11 Ch. D. 363, at p. 367 ; Equitable Life Assurance Sy. v. General Accident Assurance Corp. (1904) 12 S.L.T. 348, at p. 349 ; Joel v. Law Union & Crown Ins. Co. Ltd [1908] 2 K.B. 863, at p. 883 ; Cantiere

⁷⁷YB 2 Hen 4, fo 3, pl 9

⁷⁸From Justice Spelman's MS Reports, 93 YB Sel Soc 4 (*Pykeryng v. Thurgoode*)

⁷⁹4 Co. Rep. 91a, Yelv 21, Moore KB 433, 667.

*contract*⁸⁰ seemed to rest on the basis of the notion of good faith. In addition, common law recognized the usages and customs of the merchants, including the practice of insurance, as being part of common law. Through this process, the civil law concept of good faith was gradually assimilated into English common law.⁸¹

There are some examples of the application of the concept of the duty of good faith in the English common law. For instance, if a contract gives discretionary powers to a party, these powers should be exercised in good faith.⁸² In addition, the duty of good faith is, in some contracts, related to the concept of fiduciary relationship between the parties, and, in certain contracts such as an insurance contract, the duty of the utmost good faith is specially required.

2.2.3. HISTORY OF *UBERRIMA FIDES* IN INSURANCE LAW

2.2.3.1. ORIGIN OF THE PRINCIPLE

The earliest and the most famous case on the doctrine of *uberrima fides* (the duty of disclosure) in insurance contracts is Lord Mansfield's decision in *Carter v. Boehm*⁸³ in the eighteenth century. This case concerned a policy against the capture of Fort Marlborough on the island of Sumatra by an European enemy, effected on behalf of the governor of the fort. After this fort was captured by the French, the assured claimed under this policy. As a defence against this claim, the insurer pleaded that the assured

⁸⁰A. Simpson, "The Place of Slade's case in the history of contract", (1958) 74 Law Quarterly Review 381 (hereafter L.Q.R.) ; R. Helmholz, "Assumpsit and *Fidei Laesio*", (1975) 91 L.Q.R. 406 ; D. Ibbetson, "Assumpsit and Debt in the early sixteenth century; The origins of the indebitatus count", (1982) 41 Cambridge L.J. 142 ; J. Baker, "New Light on Slade's Case", (1971) Cambridge L.J. 51, 213

⁸¹R. Davis, *Ibid.*, at pp. 77-80

⁸²See, D. Lloyd, "Disciplinary Powers of Professional Bodies", (1950) 13 M.L.R., at p. 281 ; "Judicial Review of Expulsion by a Domestic Tribunal", (1952) 15 M.L.R., at p. 413

⁸³(1776) 3 Burr. 1905

had failed to disclose material facts that the fort in question was not strong and solid enough to withstand attack from enemy. The insurer also argued that the assured did not inform them of the probability that the French would attack this fort.

Lord Mansfield in his judgment referred to the principle of *uberrima fides*, saying that ;

"Insurance is a contract upon speculation. The special facts, upon which the contingent chance is to be found, lie more commonly in the knowledge of the insured only: the underwriter trusts to his representation, and proceeds upon confidence that he does not keep back any circumstance in his knowledge, to mislead the underwriter into a belief that the circumstance does not exist, and to induce him to estimate the risque as if it did not exist, The keeping back of such a circumstance is a fraud and therefore the policy is void. Although the suppression should happen through mistake, without fraudulent intention; yet still the underwriter is deceived, and the policy is void; because the risque run is really different from the risque understood and intended to be run at the time of the agreement".⁸⁴

This passage has very frequently been cited to offer a foundation for a principle of *uberrima fides*. From the above passage, it is very clear that the duty to avoid making misrepresentations is laid upon a party to a contract of insurance. However, another extended duty to disclose all material to the proposed risk is additionally and strongly required from a party to a contract of insurance. The principle is that an applicant in applying for insurance should disclose material facts within his exclusive knowledge to the insurer, whether or not the applicant thinks those facts are material.

The fact that the mutual trust and confidence between the parties are the bases for insurance contracts seems to be the reason for this requirement of the duty of utmost good faith. It is not possible for the doctrine of *caveat emptor* to be applied to insurance contracts as a result of the above fiduciary nature of insurance contracts. A more careful reading of this passage is leading to the view that this passage contains several interesting and crucial issues for the analysis of the duty of disclosure.

2.2.3.1.1. NECESSITY OF FRAUD

⁸⁴Ibid., at pp. 1909-1910.

The first issue in Lord Mansfield's judgment is whether the existence of fraud is essential to decide a breach of the duty. From the above passage, Lord Mansfield's emphasis seems to be put on the mere fact of whether the insurer has been misled or not. In other words, the existence of fraud in cases of non-disclosure looks immaterial. However, his view as to the necessity of fraud in relation to a breach of the duty seemed to have been modified in Mayne v. Walter.⁸⁵ In this case, the insured lost his supercargo as a result of capture by a French privateer. As a defence against the claim for recovery, the insurer argued that the insured had not disclosed a French ordinance which prohibited Dutch ships from carrying supercargo of any country at war with France. The penalty for a breach was the confiscation of such cargo. Lord Mansfield found for the insured, saying ;

"It must be a fraudulent concealment of circumstances that will vitiate a policy."⁸⁶

This view has not been supported in subsequent decisions, and the general view in England is still that no intention to deceive is required in case of non-disclosure in both marine and non-marine insurance.⁸⁷ However, a more persuasive view seems to be that fraud or intention to deceive should be required for the contract to be vitiated. In most of the cases, the principle of non-disclosure has applied to the insured, not to the insurer. The range of application of this principle to the insured is unduly wide, and the tendency of the courts has been in favour of the insurer. Under these circumstances, the view that fraud or intention to deceive should be required to avoid the contract will relieve the

⁸⁵See, the report in Parks, *The Law of Marine Insurance* (1787) at p. 220

⁸⁶*Ibid.*, at p. 221 ; The same view is found in Hambrough v. Mutual Life Insurance Co. of N.Y. (1895) 72 L.T. 140, at p. 141. It held that "In policies of insurance on life, an erroneous statement respecting the life insured, or mere silence respecting a material fact, in the absence of any fraudulent intention, does not avoid the policy..." ; London Assurance v. Mansel (1879) 11 Ch. D. 363, at p. 370

⁸⁷Lindenau v. Desborough (1828) 8 B. & C. 586 ; Elton v. Larkins (1832) 8 Bing. 198 ; Bates v. Hewitt (1867) L.R. 2 Q.B. 595. ; Anderson v. Pacific Fire and Marine Ins. (1872) L.R. 7 C.P. 65.

insured from the unduly heavy burden by limiting its application. This view has been supported, at least in non-marine insurance, in the U.S.A.⁸⁸

The recent decision in the House of Lords in Pan Atlantic Insurance Co. Ltd v. Pine Top Insurance Co. Ltd⁸⁹ held that the non-disclosure or misrepresentation must have been an actual inducement to the insurer to enter into the contract, if the insurer is to be allowed to avoid. It has been said that there are two factors which constitute inducement. The existence of the representor's intention to induce is the first one, and the actual result of inducing the representee to alter his position is the second factor. These two factors should be proved or imputed altogether. Based on this decision, it would appear that traditional view might cause some difficulties in practice, and the view that requires the insured's intention to deceive seems to be more compatible with this decision.

2.2.3.1.2. NATURE OF RECIPROCITY

The next issue underlined in Lord Mansfield's judgment in Carter v. Boehm is whether this duty can be equally applied to the insurers. Lord Mansfield stated ;

"The policy would be equally be void, against the underwriter, if he concealed; if he insured a ship on her voyage, which he privately knew to be arrived: and an action would lie to recover the premium Good faith forbids either party by concealing what he privately knows, to draw the other into a bargain, from his ignorance of that fact, and his believing the contrary... This definition of concealment,... will generally hold to make it void, in favour of the party misled by his ignorance of the thing concealed.⁹⁰

From this passage, it is clear that the duty of disclosure in insurance contracts is a mutual one, imposing the same or similar reciprocal duty to disclose material facts known by one party but not by the other upon the insured and the insurer as well.

⁸⁸Hartford Protection Ins. Co. v. Harmer, 1853, 2 Ohio St. 452, at p. 472, 59 Am.Dec. 684 ; Also see, Transcontinental Ins. Co. v. Minning, C.C.A. Ohio, 1943, 135 F.2d. 479

⁸⁹[1994] 3 W.L.R. 677

⁹⁰(1776) 3 Burr. 1905, at pp. 1909-1910

Nonetheless, the tendency of the courts and the customary practice in the insurance market on this issue have been far from the principle of mutuality. In other words, this duty has rarely been applied to an insurer.⁹¹

2.2.3.1.3. EFFECT OF BREACH OF DUTY

The third issue from the judgment of Lord Mansfield is the effect of the breach of this duty, which is different from that of the present practice and legislation. Lord Mansfield said that a breach of the duty of disclosure renders a contract void. However, the current relevant law stipulates that;

"If the assured fails to make such disclosure, the insurer *may* avoid the contract."⁹²

Therefore, unlike Lord Mansfield's passage, the current practice is that the insurer may avoid the contract if he wishes, and whether or not the contract will be avoided depends on the insurer's option. In other words, the insurer may continue his contract if he wishes, despite non-disclosure of material facts by the insured.

2.2.3.1.4. SCOPE OF APPLICATION OF DUTY

The fourth point is Lord Mansfield's view of the general applicability of the doctrine of good faith to all contracts and dealings.⁹³ This view implied his preference for a narrow interpretation on the scope of the duty of disclosure, considering the fact that the doctrine of good faith would be applied to all kinds of contracts and dealings. His view was that the duty of the insured is only required when the insured *exclusively* knew something of which the insurer is ignorant.⁹⁴ Lord Mansfield impliedly stated the scope of the duty ;

⁹¹For more detailed discussion, see Ch. 7 of this thesis.

⁹²S. 18(1) of the M.I.A. 1906

⁹³(1776) 3 Burr. 1905, at p. 1910.

⁹⁴*Ibid.*, at p. 1911 ; R. Hasson, "The Doctrine of *Uberrima Fides* In Insurance Law - A Critical Evaluation", (1969) 32 M.L.R. 615, at pp. 616-618

"The underwriter knew the insurance was for the governor. He knew the governor must be acquainted with the state of the place. He knew the governor could not disclose it, consistently with his duty. He knew the governor, by insuring, apprehended, at least, the possibility of an attack. With this knowledge, without asking a question, he underwrote. By so doing, he took the knowledge of the state of the place upon himself. It was a matter, as to which he might be informed in various ways: it was not a matter, within the private knowledge of the governor only."⁹⁵

From this passage, it is clear that if an insurer "*might*" be informed of the material facts no matter how, it cannot be said that those facts are the exclusive knowledge of an insured which should be disclosed to the insurer. Under the circumstances of the facts in Carter v. Boehm, it would appear that the state of the fort was not within the exclusive private knowledge of the insured any more. In other words, according to Lord Mansfield's thought, the scope of the duty of disclosure is limited to the facts or circumstances which are within the exclusive knowledge of the applicant whether or not he regards them as material. This passage seems to support the view that a positive role or responsibility for gaining access to the relevant material information should be additionally imposed on the insurer in relation to the insured's duty of disclosure. Likewise, the scope of the original nature of this duty by Lord Mansfield was reasonably limited, and consequently the duty of the insured was only required when the insured exclusively knew something of which the insurer was ignorant, and when the insurer had no reason to suspect. It would appear that this view, i.e., the insurer has a positive responsibility to obtain access to the relevant material information in relation to the insured's duty of disclosure, is consistent with ss. 18 (3)(b) and 18(b)(c) of the M.I.A. 1906.⁹⁶ Lord Mansfield's narrow view on the duty of disclosure on the part of

⁹⁵Ibid., at p. 1915

⁹⁶S. 18(3) of the M.I.A. 1906 ; "In the absence of inquiry the following circumstances need not be disclosed... (b) Any circumstance which is known or presumed to be known to the insurer. The insurer is presumed to know matters of common notoriety or knowledge, and matters which an insurer in the ordinary course of his business, as such, ought to know". (c) Any circumstance as to which information is waived by the insurer.

the insured was supported in other cases.⁹⁷ Likewise, the original nature of the duty of disclosure on the part of the insured developed during the eighteenth century was narrow.

2.2.3.2. CHANGE OF NATURE OF DUTY

2.2.3.2.1. INTRODUCTION

Lord Mansfield repeatedly expressed his narrow view as to the application and the scope of the insured's duty of disclosure throughout the eighteenth century. Indeed, no case has been found in which the insurer's defence of *uberrima fides* succeeded before Lord Mansfield.⁹⁸ It would appear that Lord Mansfield and the other judges in the eighteenth century tried fairly to interpret the duty of disclosure without giving a special advantage to one party to the contract of insurance. However, this tendency signalled a dramatic change in the following centuries. In other words, the narrow view of the insured's duty was replaced by a broad view in terms of the application and the range of this duty. Undoubtedly, the beneficiary of this broad view has been the insurer.

2.2.3.2.2. FLUCTUATION OF THIS PRINCIPLE

The narrow view of the insured's duty of disclosure which was established in the 18th century had not sustained its position when the new century begun.⁹⁹ Lindenau v.

⁹⁷See, Nobel v. Kennoway (1780) 2 Doug. 510, where the underwriter was under a duty to inform himself with respect to the practice of the trade that he insured. ; Court v. Martineau (1782) 2 Doug. 161 in which it was held that the insurer had waived the need to get material information from the insured by accepting a large premium in relation to the risk insured. ; Fiere v. Woodhouse (1817) 1 Holt N.P. 572 , where the insurer's fair inquiry and due diligence to get material information were strongly required.

⁹⁸R. Hasson, "The Special Nature Of The Insurance Contract: A Comparison Of The American And English Law Of Insurance", (1984) 47 M.L.R. 505, at p. 508.

⁹⁹See, generally, R. Hasson, "The Doctrine of *Uberrima Fides* In Insurance Law - A Critical Evaluation", (1969) 32 M.L.R. 615, at pp. 618-621

Desborough¹⁰⁰ has been frequently cited to show the starting point of the changed tendency of the courts as to the application or the interpretation of the duty of disclosure. This case dealt with the life insurance of a '*foreigner*'. The peculiar circumstance of this case gave the insurer no alternative but to believe and rely on the statement of the assured's (Duke of Saxe Gotha) doctors in Germany who had not mentioned the Duke's mental faculties, which was material information in this case. The insurer's requiring the Duke to come to England for an independent medical examination seemed to be very difficult in this case, even though it was not impossible. This peculiarity of the facts was pointed out by Lord Tenterden J, saying that "In the present case, the insurance was upon the life of a *foreigner*."¹⁰¹ Considering this unusual fact, the decision of the court in favour of the insurer seemed to be reasonable.

However, the reason why this case has so frequently been cited to criticise the wide range of the insured's duty of disclosure may be found in the opinions on this matter delivered by Bayley J. He expressed his own view of the duty of disclosure on the part of the insured, saying ;

"I think that in all cases of insurance, whether on ships, houses, or lives, the underwriter should be informed of every material circumstance within the knowledge of the assured; and that the proper question is, whether any particular circumstance was in fact material? and not whether the party believed it to be so. The contrary doctrine would lead to frequent suppression of information, and it would often extremely difficult to shew that the party neglecting to give the information thought it material. But if it be held that all material facts must be disclosed, it will be the interest of the assured to make a full and fair disclosure of all the information within their reach."¹⁰²

It would appear that this judgment is different from what Lord Mansfield said in Carter v. Bohem - an insured must disclose material facts only within his *exclusive* knowledge, and an insurer also has a *positive responsibility* to gain access to the relevant material

¹⁰⁰(1828) 8 B. & C. 586

¹⁰¹Ibid., at p. 591.

¹⁰²Ibid., at pp. 592-593 ; Also see, the opinion by Littledale J. Ibid., at p. 593

information. As a result of Bayley J.'s interpretation, the insured's duty of disclosure began to extend to its scope. Moreover, it could apply to cases where the insured had no intention to deceive the underwriter including an innocent non-disclosure. Consequently, the scope of the duty of disclosure was substantially expanded. However, it is arguable whether this decision is a relevant example to criticise the wide range of the insured's duty of disclosure because of the peculiarity of the facts of this case.

Undoubtedly, *Bates v. Hewitt*¹⁰³ is the most significant case for the discussion of this issue, because of the plain facts of the case and the bold decision. The fact of this case is as follows: During the American civil war, in 1863-4, the *Georgia*, a sailing vessel, obtained notoriety as a Confederate cruiser. In May, 1864, she was dismantled in Liverpool and sold to the plaintiff. This was known to the defendant, an underwriter at Lloyd's because of the public notoriety. In August, 1864, the plaintiff effected an insurance of the vessel for six months. When the risk was proposed, nothing reminded the insurer of her past career as a Confederate cruiser and he remained unaware of it. It was a voyage policy from Liverpool to Lisbon and the Portuguese settlements on the west coast of Africa and back. The vessel sailed from Liverpool, and was immediately captured by a frigate from the United States. In the action to recover the loss, the defendant set up as a defence the concealment of the fact that the *Georgia* was an ex-Confederate cruiser, and therefore liable to capture by the United States.

Surprisingly enough, it was the insurer who was the successful party in this litigation. All three of the judges expressed the unjustly broad view on the insured's duty of disclosure.¹⁰⁴ In fact, the court admitted that if the underwriter, who had abundant means of identifying the ship from the information such as Lloyd's registers and his

¹⁰³(1867) L.R. 2 Q.B. 595

¹⁰⁴*Ibid.*, at pp. 604-605, (Lord Cockburn), at p. 608 (Mellor J.) and at p. 611 (Shee J.)

previous knowledge, had given sufficient consideration to the subject, they could have found out that the vessel was a Confederate cruiser. Nevertheless, the judges decided against the plaintiff, saying that if a material fact had not been communicated, which, though known to the underwriter once, was not present to his mind at the time of effecting the insurance, the non-communication afforded a good defence to the underwriter. It was not enough for the assured to show that the particular supplied by the assured, coupled with the underwriter's previous knowledge, would, if the underwriter had given sufficient consideration to the subject, have brought to his mind the material fact not communicated.

Mellor J. expressed the reason of this decision, saying that ;

"I cannot help thinking that to enable a person proposing an insurance to speculate upon the maximum or minimum of information he is bound to communicate, would be introducing a most dangerous principle into the law of insurance."¹⁰⁵

This decision showed a clearly different interpretation as to the scope of the insured's duty of disclosure from that of Lord Mansfield and his followers in the 18th century. It would appear that Mellor J.'s opinion is a lop-sided one which is clearly in favour of the insurer. Why should the insurer who was negligent of his duties be protected? Why cannot the insured, who reasonably thought, without a deceitful intention, that the insurer might know the past career of the vessel, be protected? Although many cases in the 19th century indicated a broad view of the insured's duty of disclosure, a few courts still followed the narrow and more restricted view of the duty of disclosure which seemed to follow the spirit of Lord Mansfield even in the late 1890s.¹⁰⁶

2.2.3.2.3. CURRENT INTERPRETATION OF DUTY OF DISCLOSURE

¹⁰⁵Ibid. at p. 608.

¹⁰⁶*Hambrough v. Mutual Life Insurance Co. of N.Y.* (1895) 72 L.T. 140, at p. 141, in which it was held that mere silence on the part of the insured with regard to a material fact did not avoid a policy, in the absence of fraud. ; Also see, *Wheelton v. Hardisty* (1852) 2 El. & Bl. 232, at p. 273

It would appear that the noticeable feature of the current interpretation of the duty of disclosure in the courts is the broad interpretation as to the scope of the duty, which is clearly in favour of insurer only. The decision in *Joel v. Law Union and Crown Insurance*¹⁰⁷ has made it clear that the scope of the duty of disclosure was broad. The facts of this case were as follows; M (woman) had completed a proposal form, the contents of which were declared to be the basis of the contract, and none of the answers was untrue. She was then examined by a doctor acting for the defendants who completed a printed form for the purpose of assessing whether her life was suitable to be insured. She signed a declaration at the bottom of this form to the effect that the answers were all true, but this form was not declared to be the basis of the contract. The form asked M to give the names of doctors consulted by her and also asked whether she had ever suffered from mental derangement. The name of the doctor she had consulted for nervous breakdown following influenza was not inserted and a negative answer was given to the second question. In fact, though unaware of the fact, M had been confined for acute mania. The defence for the breach of the duty to disclose material facts was set up by the insurer, and consequently the insurers repudiated a policy of life insurance. Fletcher Moulton L.J. made a boundary of a fact which should be disclosed by the insured, saying that "you cannot disclose what you do not know."¹⁰⁸ This interpretation is quite right. However, he continued to say that it was not sufficient for the insured to disclose to the insurer only what he thought to be material, and that the underwriter should be informed of every material circumstance within the knowledge of the insured. Therefore, the proper question is whether any particular question was actually material and not whether the party believed it to be so.¹⁰⁹ As to this point, Fletcher Moulton L.J. said ;

¹⁰⁷[1908] 2 K.B. 863.

¹⁰⁸*Ibid.*, at p. 884

¹⁰⁹*Ibid.*, at p. 884 ; Also see, *Lindenau v. Desborough* (1828) 8 B. & C. 586, at p. 592.

"That duty, no doubt, must be performed, but it does not suffice that the applicant should bona fide have performed it to the the best of his understanding. There is the further duty that he should do it to the extent that a reasonable man would have done it;... If a reasonable man would have recognized that it was material to disclose the knowledge in question, it is no excuse that you did not recognized it to be so."¹¹⁰

This passage means that if the insured does not disclose something because he honestly and fairly considers the matter non material, the insured breaches his duty and the policy is avoided. In other words, if the insured does not disclose a fact because he reasonably thought it was immaterial, but which is in fact material to the insurer, this is still a failure of disclosure.¹¹¹ According to Fletcher Moulton L.J.'s reasoning, the disclosure must be of all you ought to have realized to be material, not of only that which you did in fact realize to be so. Therefore, the insured should disclose every material fact within his actual knowledge and constructive knowledge - a fact which in the ordinary course of business the insured might reasonably be expected to be aware. Consequently, an innocent non-disclosure can also vitiate the policy. The formidable position of the insurer, in the Joel case, was much more secured by the practice of the basis of the contract clause. As a result, the insurer could rely on both the stringent principle of *uberrima fides* and the practice of the basis of the contract clause.

The wide and stringent interpretation of the insured's duty of disclosure has continued throughout this century in England. This tendency was well illustrated recently by the Court of Appeal in Lambert v. Co-operative Insurance Society Ltd.¹¹² In 1963, the plaintiff (woman) completed a proposal form for the defendant's "All Risks" policy to cover her and her husband's jewellery. No questions as to previous convictions were asked and the proposer did not disclose that her husband had been convicted for receiving stolen cigarettes and fined £25 some years ago. Conditions of the policy stated

¹¹⁰[1908] 2 K.B. 863, at p. 884

¹¹¹Also see, Godfrey v. Britannic Assurance Co. [1963] 2 Lloyd's Rep. 515

¹¹²[1975] 2 Lloyd's Rep. 485

that the policy would be void if there was an omission to state any material fact. The policy had been renewed annually until 1972. In 1971, the plaintiff's husband was convicted again and sentenced to a couple of months' imprisonment for offences of dishonesty. This fact was not disclosed when the 1972 renewal was made. The plaintiff claimed £311 which was the value of jewellery in the question which was stolen. The defendant rejected the claim on the grounds of non-disclosure of the two past convictions, and the decisions in the High Court and on appeal were in favour of the insurer.

The Court of Appeal held that the insured should disclose all facts that were material to the risk and that the test of such materiality should be decided by a prudent insurer, rejecting the test of materiality suggested by the Law Reform Committee in their 5th Report that, for the purpose of any contract of insurance, no fact should be deemed material unless it would have been considered material by a reasonable insured.¹¹³ The prudent insurer test is clearly unfair to the insured because the insured may not be familiar with insurance contract law in deciding what information a prudent insurer would regard as material in a particular type of insurance risk. In other words, the prudent insurer test requires that the insured should possess clairvoyant powers to discover what a reasonable insurer would regard as material.¹¹⁴ The Law Reform Committee in their 5th Report said that ;

"(4)...it seems to us to follow from the accepted definition of materiality that a fact may be material to insurers ... which would not necessarily appear to a proposer for insurance, however honest and careful, to be one which he ought to disclose."¹¹⁵

¹¹³(Conditions and Exceptions in Insurance Policies), Cmnd. 62 (1957), at para. 14 (1) ; Also see, *Container Transport International Ins. v. Oceanus Mutual Underwriting Association (Bermuda) Ltd* [1984] 1 Lloyd's Rep. 476 ; *Highlands Insurance Co. v. Continental Insurance Co.* [1987] 1 Lloyd's Rep. 109 ; *Pan Atlantic Insurance Co. v. Pine Top Insurance Co. Ltd* [1994] 3 W.L.R. 677

¹¹⁴R. Merkin, "Uberrimae Fidei Strikes Again", (1976) 39 M.L.R. 478, at p. 479

¹¹⁵(1957) Cmnd. 62, para. 4

The interpretation of the test of materiality in the courts has been almost unilaterally in favour of the insurer only, and the meaning of a prudent insurer as a standard for determining materiality has been in a centre of the criticism. The practice of expert evidence also produces injustice in terms of fairness and equality between the insurer and the insured. The insured will have a considerable difficulty in finding expert evidence, whereas the insurer will have no difficulty in calling in expert evidence from his fellow insurers in the big insurance industry. The broad interpretation of s. 18(2) of the M.I.A. 1906, i.e., the anti-dicisive influence test, is another severe blow to fair dealing between the two parties.¹¹⁶

The Lambert case also showed that by requiring the insured to answer the questions in a proposal form, the insurer did not waive the need to disclose material facts which were not on the list of questions in the form.¹¹⁷ In other words, the insured is not relieved of his residual duty of further disclosure even in the case that the insurer has not asked specific questions of him in a proposal form, even though the insured is thereby highly likely to believe that no further information is required to be disclosed by him. Likewise, the residual duty to disclose any other material is imposed on the insured no matter how detailed and lengthy the proposal form is, even though the insured may be unaware of the existence of the duty of disclosure itself. In the case of renewals, the same strict rules exist on every renewal.¹¹⁸

¹¹⁶The full analysis of the current test of materiality will be discussed in Ch. 5 of this thesis. As to the test of materiality in relation to the insurer's duty of disclosure, see, Ch. 7.

¹¹⁷Also see, *Glicksman v. Lancashire & General Assuracne Co. Ltd* [1927] A.C. 139 ; *Schoolman v. Hall* [1951] 1 Lloyd's Rep. 139

¹¹⁸R. Hodgin, "Insurance law reform", [1981] Lloyd's Maritime and Commercial Law Quarterly 284, at p. 287 (hereafter L.M.C.L.Q.)

Likewise, this current English interpretation on the duty to disclose could lead to an absurd result, and in fact there have been a lot of authorities which criticize that the English courts' tendencies. The duty of disclosure is strict in nature. This duty has been extended beyond the scope of good faith and fair dealing which are the original purpose of this principle. According to this broad scope of the insured's duty of disclosure, a fact could be material to the insurers even when the insured, however honest and careful, would not necessarily regard it as something material which should be disclosed. For instance, according to the case law, when an insured tries to place an insurance policy with an insurer in the market, he should disclose to that insurer the fact that an underwriter in a totally different kind of insurance has previously rejected him. This decision requires too wide scope of the duty and it is undoubtedly absurd. The correct position should be that the information undisclosed by the insured must be closely related to the risk in question.

Again, the practice of insurer's waiver has been hardly adopted where the insurer fails to ask questions concerning a specific matter in a proposal form. Instead of it, the courts, in most cases, entitle the insurer to raise a defence on the ground of non-disclosure of a material fact.¹¹⁹ In addition, the *uberrimae fidei* nature of insurance contracts entitles even imprudent insurers to a fair presentation of the risk. In Pan Atlantic Insurance Co. Ltd v. Pine Top Insurance Co. Ltd¹²⁰, a reinsurance policy was broked in such a way as to avert the insurer's attention from a bad long term record. The parties agreed that there was no allegation of fraud and it was inadvertently made. In this case, the true material

¹¹⁹Locker & Woolf Ltd v. Western Australian Insurance Co. [1936] 1 K.B. 408 ; Schoolman v. Hall [1951] 1 Lloyd's Rep. 139 ; Roselodge Ltd v. Castle [1966] 2 Lloyd's Rep. 113 ; Also see, Glicksman v. Lancashire and General Assurance Co. [1927] A.C. 139, where the insurer who put a very ambiguous question to the insured was protected by the court. ; Also see, Horne v. Poland [1922] 2 K.B. 364 ; Regina Fur v. Bossom [1957] 2 Lloyd's Rep. 466 ; Woolcott v. Sun Alliance and London Insurance [1978] 1 W.L.R. 493

¹²⁰[1994] 3 W.L.R. 677

fact would have been available to the insurer, if he had been careful, but, unlike the common practice of the prudent insurer, he did not pay attention to it. Instead of the court's recognition of the insurer's waiver of the material fact, it was held that the insurer was entitled to avoid his liability on the ground of non-disclosure of a fact from the short term record.. In the end, an imprudent insurer, who did not pay attention to the most important fact, successfully escaped his liability.¹²¹

This harshness and hardship were recognized by the courts. For instance, all three judges in the Court of Appeal in Lambert v. Co-operative Insurance Society Ltd expressed their regret on the test of a prudent insurer and criticised the existing law.¹²² Also, in Provincial Insurance Co. v. Morgan¹²³, Lord Wright said that ;

"An assured may easily find himself deprived of the benefits of the policy because he has done something quite innocently but in breach of a condition, ascertainable only by the dovetailing of scattered portions."¹²⁴

In addition, this wide-ranging nature of this duty of disclosure has been repeatedly criticised in the literature.¹²⁵ In 1980, the Law Commission had an opportunity to

¹²¹Also see, Newbury International Ltd v. Reliance National Insurance Co. (U.K.) Ltd [1994] 1 Lloyd's Rep. 83

¹²²[1975] 2 Lloyd's Rep. 485, at p. 491 (MacKenna J.), at p. 492 (Lawton L.J.) and at p. 493 (Cairns L.J.)

¹²³[1933] A.C. 240

¹²⁴Ibid., at p. 252 ; Also see, Glicksman v. Lancashire & General Assurance Co. [1927] A.C. 139, at pp. 143-144

¹²⁵F. Achampong, "Uberrima Fides in English and American Insurance Law : A Comparative Analysis" (1987) 36 International and Comparative Law Quarterly 329 (hereafter I.C.L.Q.) ; R. Hasson, "Uberrima Fides in Insurance Law - A Critical Evaluation" (1969) 32 M.L.R. 615 ; "The Special Nature of the Insurance Contract : A Comparison of the American and English Law of Insurance" (1984) 47 M.L.R. 505 ; "Good Faith in contract Law - Some Lessons from Insurance Law" (1987-1988) 13 Canadian Business Law Journal 93 (hereafter Can. Bus. L.J.) ; R. Merkin, "*Uberrimae Fidei* strikes again" (1976) 39 M.L.R. 478 ; J. Birds, "What is a cover-note worth?" (1977) 40 M.L.R. 79 ; "The Reform of Insurance Law" [1982] Journal of Business Law 449 (hereafter J.B.L.)

examine the current practice of the duty of disclosure.¹²⁶ The Law Commission accepted the view that the present law as to non-disclosure is defective. However, the Law Commission had an objection to both the abolition of the duty of disclosure and the attenuated duty of disclosure, saying that ;

"... it was significant that some duty of disclosure was imposed on the insured not only by the draft Directive but also by the laws of all the common law and civil law jurisdictions which we had been able to study."¹²⁷

In addition, the English practice that there is no distinction between non-marine insurance cases and marine insurance cases for the insured's duty of disclosure should be changed. It is relatively difficult for the subject of marine insurance to be seen or inspected by the insurer before he takes the risk. Therefore, the marine insurer has to rely more on the information from the insured. However, these reasons are less persuasive in non-marine insurance cases. Also, in marine insurance it is immaterial that another underwriter has previously refused the risk, whereas in non-marine insurance this fact has been sometimes held to be a material fact which should be disclosed.¹²⁸ These differences should be considered, because the range of the insured's duty of disclosure will be inevitably different between them. In the U.S.A., the distinction between marine insurance and non-marine insurance cases has already been made.¹²⁹ In addition, the practice of warranty - the basis of the contract - has placed the insurer in a much more powerful position. The meaning of warranty which is usually made at the foot of the proposal form is that the proposer warrants his answer to be absolutely true and complete. It means that the proposal form is to form the basis of the contract.

¹²⁶The Law Commission, Insurance Law : Non-disclosure and Breach of Warranty, Cmnd. 8064 (1980) ; For more detailed discussion of reform, see, Ch. 9 of this thesis.

¹²⁷*Ibid.*, at paras. 4.32-4.40 (abolition) and at paras. 4.41-4.42 (attenuation)

¹²⁸*London Assurance v. Mansel* (1879) 11 Ch. D. 363 ; *Re Yarger and Guardian Assurance Co.* (1912) 29 T.L.R. 53 ; *Glicksman v. Lancashire and General Insurance Co.* (1927) A.C. 139 ; *Cornhill Insurance v. Assenheim* (1937) 58 Ll.L.R. 27

¹²⁹For more detailed discussion, see, sub-chapter 2.2.4.2.2 of this thesis.

Therefore, the effect of this practice is to change all the representation on the proposal form into warranties. Consequently, any small inaccuracy as to the representation on the form entitles the insurer to avoid the policy, whether it is material or not. Even innocent mistake has the same consequence.¹³⁰

2.2.4. ANALYSIS OF COMPARATIVE LAW

2.2.4.1. DUTY OF DISCLOSURE IN CANADA¹³¹

In Canada, the scope of the insured's duty of disclosure is narrower than in England. There is no doubt at all that the decision in Carter v. Boehm ¹³² in England influenced the Canadian courts on this issue. However, the tendency of the Canadian courts has been different from that of English courts. Some devices have been introduced to protect the insured, therefore the position of the insured in Canada is relatively secured, as compared with that in England. In life insurance, the "incontestable" clause, which was originally made in the U.S.A., has been introduced. As a result of this, an insurer in life insurance is not allowed to reject the insured's claim for a breach of the duty of disclosure after the policy in question has been in force for two years, unless there is fraud and the insurer can prove fraud.¹³³ To prove the intention to deceive in relation to non-disclosure seems to have been very difficult, considering the number of past

¹³⁰However, this practice of warranty is now controled by the Statement of Insurance Practice. Therefore, the hardship the insured would have is now allayed. See, cl 1(b) of the Statement of General Insurance Practice and cl 1(b) of the Statement of Long-Term Insurance Practice.

¹³¹Generally see, Brown and Menezes, *Insurance Law in Canada*, (2nd ed., 1991), Ontario ; Crawford, Baer, Donald and Rendall, *Cases on the Canadian Law of Insurance*, (1971), The Carswell Company Ltd. ; *Digest - Annotated British, Commonwealth and European Cases*, Vol. 29 (Insurance, 1982 ed.), Butterworths ; R. Hasson, "Good Faith in Contract Law - Some Lessons from Insurance Law -" (1987-1988) 13 Can. Bus. L. J. 93, at pp. 100-110 ; Baer, "Recent Developments in Canadian Law: Insurance Law", (1985) 17 Ottawa L.R. 631

¹³²(1776) 3 Burr. 1905

¹³³W. Young Jr., "'Incontestable' - as to What?", (1964) Univ. of Ill. Law Forum 323

reported cases where the insurer was successful in proving the insured's fraud. Berthiaume v. Great West Life Ass'ce Co.¹³⁴ is one of rare cases in which the insurer successfully proved the insured's fraud. A similar incontestable clause has been established in disability insurance as well.¹³⁵

In fire insurance, an insured is also protected by the practice which requires an insurer to prove the insured's fraud in relation to his non-disclosure in order to avoid the policy. In Taylor v. London Ass'ce Corp.¹³⁶, the court held that fraud in relation to the issue of non-disclosure meant common law fraud, not equitable fraud. Therefore, it is almost impossible to prove fraud when the contracting party says nothing at all. It can be said that the insured's duty of disclosure has been virtually abolished in fire insurance, because since this decision was delivered, there has been no reported case in which an insurer succeeded in proving fraudulent non-disclosure. In conclusion, the insured in Canada has enjoyed a better position in insurance contracts than in England, since the insured's duty of disclosure has been narrowly applied and the range of it has been significantly restricted.

2.2.4.2. DUTY OF DISCLOSURE IN AMERICA¹³⁷

2.2.4.2.1. INTRODUCTION

¹³⁴(1945) 12 I.L.R. 84

¹³⁵See, s. 262 of the Ontario Insurance Act

¹³⁶[1935] 3 D.L.R. 129

¹³⁷Generally see, R. Keeton and A. Widiss, *Insurance Law - A Guide to Fundamental Principles, Legal Doctrines and Commercial Practices* -, (1988), St. Paul, Minn. ; R. Keeton, *Insurance Law - Basic Text*, (1971), St. Paul, Minn. ; E. Patterson and W. Young, *Cases and Material on Insurance Law*, (4th ed., 1961), New York ; E. Patterson, *Essentials of Insurance Law*, (2nd ed., 1957), New York ; W. Vance, *Handbook on the Law of Insurance*, (3rd ed. by B. Anderson, 1951), St. Paul, Minn. (hereafter W. Vance) ; W. Young and E. Holmes, *Cases and Material on the Law of Insurance*, (2nd ed., 1985), New York ; R. Hasson, "Good Faith in Contract Law - Some Lessons from Insurance Law -" (1987-1988) 13 Can. Bus. L. J. 93, at pp. 110-120

In the U.S.A., the concept of a common law duty of disclosure was recognized in Stipcich v. Metropolitan Life Insurance Company¹³⁸ where the court said that *uberrima fides* was applied to all insurance contracts. In this case, Mr. Justice Stone said that "the most elementary spirit of fair dealing would seem to require him (the insured) to make a full disclosure."¹³⁹ In Hare and Case v. National Surety Co.¹⁴⁰ Swan J. confirmed the fact that the English principle of the insured's duty of disclosure developed in Carter v. Boehm¹⁴¹ was also adopted in the U.S.A. However, it would appear that the American courts have more faithfully followed the principle of the insured's duty of disclosure in the eighteenth century - the narrow scope of duty of disclosure and the liberal tradition of Lord Mansfield.¹⁴² American insurance law and the tendency of the courts, at least as far as the rules developed in the first three decades of this century are concerned¹⁴³, provided more protection for the insured on the issue of non-disclosure than the English rules of insurance law.¹⁴⁴ For instance, the American courts upheld all kinds of statutes whose purposes were to regulate and control the insurance industry.¹⁴⁵ In addition, Judge Taft in Penn Mutual Life Insurance Co. v. Mechanics' Savings Bank and Trust

¹³⁸277 U.S. 311 (1928)

¹³⁹Ibid., at p. 317

¹⁴⁰60 F.2d 909 (2nd Cir. 1932)

¹⁴¹(1776) 3 Burr. 1905

¹⁴²See, R. Chorley, "Liberal Trends in Present-Day Commercial Law", (1940) 3 M.L.R. 272, at pp. 278-279

¹⁴³Since the World War II, the insurance industry has been a better position than ever through the exemptions from the Uniform Commercial Code and from the Federal Anti-Trust statutes. Also, the insurers can be protected by the McCarran-Ferguson Act of 1945, etc. ; See, G. Gardner, "Insurance and the Anti-Trust Laws", (1948) 61 Harvard Law Review 246 (hereafter Harv. L.R.)

¹⁴⁴See, E. Patterson, "The delivery of a life insurance policy", (1919) 33 Harv. L. R. 198 ; F. Kessler, "Contracts of Adhesion - Some thoughts about Freedom of Contract", (1943) 43 Columbia L.R. 629

¹⁴⁵See, Whitfield v. Aetna Life Co. of Hartford, 205 U.S. 489 (1907) ; New York Life Ins. Co. v. Deer Lodge County, 231 U.S. 495 (1913)

Co.¹⁴⁶ held that the insured need not disclose "self-disgracing facts". This decision implied that the insured's duty of disclosure could be reduced to significant proportions. Likewise, in the U.S.A., the insured's duty of disclosure seems to have been reduced to a "remnant" in the law.¹⁴⁷

2.2.4.2.2. AMERICAN DOCTRINE

In marine insurance, it would appear that the American doctrine as to the insured's duty of disclosure is similar to that developed in England. Therefore, if the insured actually knew material facts, or if the insured could have reasonably discovered those facts in the ordinary course of business, he should disclose it to the insurer. If he did not disclose it, the policy would be voidable at the insurer's option, regardless of fraud. This was confirmed in Sun Mutual Insurance Co. v. Ocean Insurance Co.¹⁴⁸ In Burritt v. Insurance Co.¹⁴⁹, Bronson J. said;

"In marine insurance, the misrepresentation or concealment by the assured of a fact material to the risk will avoid the policy, although no fraud was intended ... Although no fraud was intended by the assured, it is nevertheless a fraud upon the underwriter, and avoids the policy."¹⁵⁰

On the other hand, in non-marine insurance, the importance of the insured's duty of disclosure has been very much modified and attenuated. In general, the insured's duty of disclosure only affects the validity of the policy in cases where the facts undisclosed were known to be material by the insured and where those facts were undisclosed by the

¹⁴⁶72 F. 413 (C.C.A. 6th, 1896), at p. 435

¹⁴⁷See, B. Harnett, "The Doctrine of Concealment : A Remnant in the Law of Insurance", (1950) 15 Law and Contemporary Problems 391 ; R. Hasson, "The Special Nature of the Insurance Contract ; A Comparison of the American and English Law of Insurance", (1984) 47 M.L.R. 505, at pp. 505-506

¹⁴⁸1882, 107 U.S. 485, 1 S.Ct. 582, 27 L.Ed. 337

¹⁴⁹1843, 5 Hill (N.Y.) 188, 40 Am. Dec. 345

¹⁵⁰Also see, Cox v. Blake Co., 1917, 100 Misc. 135, 166 N.Y.S. 294

insured in bad faith with intent to defraud the insurer.¹⁵¹ The insurer should prove that the insured's non-disclosure was fraudulent to avoid the policy.¹⁵² In Penn Mutual Life Insurance Co. v. Mechanics' Savings Bank and Trust Co.¹⁵³, Taft J. said that;

"it is clearly just to require that nothing but a fraudulent non-disclosure shall avoid the policy."¹⁵⁴

The burden of proving fraud seems to be very heavy. Of course, it has been said that if an undisclosed fact is palpably material to the risk, the mere non-disclosure is itself strong evidence of a fraudulent intent. Therefore, in this context, the insurer may be relieved from that heavy burden to prove fraud. Apart from the necessity of fraud to avoid the policy, in life insurance, the insured's duty of disclosure has been much more attenuated by the existence of the "incontestable" clause. Unlike Canada where this "incontestable" clause is also prevalent in life and disability insurance, in the U.S.A., once the policy has been in force for one or two years, the insurer will not be allowed to avoid the policy even if the insurer can prove fraud.

The reasons for the distinction between marine and non-marine insurance in relation to the scope of the insured's duty of disclosure and the effect of its breach in the U.S.A. are as follows. The subject of non-marine insurance may be more easily seen and inspected by the insurer through his own inquiry or other ways before he makes a contract. That is to say, the insurer has almost unlimited access to the subject matter of the insurance in order to obtain information. It is an established practice in life insurance to ask the insured to answer the questionnaire put to him by the insurer. This practice implies that

¹⁵¹W. Vance, at p. 368

¹⁵²Sebring v. Fidelity - Phenix Ins. Co., 1931, 255 N.Y. 382, 174 N.E. 761 ; Sun Ins. Office v. Mallick, 1931, 160 Md. 71, 153 A. 35 ; Also see, E. Patterson, Essentials of Insurance Law, (2nd ed., 1957), New York, at pp. 446-449 ; R. Keeton, Insurance Law - Basic Test, (1971), St. Paul, Minn., at pp. 236-238 ;

¹⁵³72 F. 413 (C.C.A. 6th, 1896)

¹⁵⁴Ibid., at p. 435 ; Also see, Roberto v. Hartford Fire Insurance 177 F.2d 811 (7th Cir., 1949)

facts not asked for by the insurer are deemed to be immaterial.¹⁵⁵ On the other hand, it is not easy for the subject of marine insurance to be seen or inspected by the insurer before he takes the risk. In other words, predicting the perils which the vessels on the sea might encounter and making the questionnaires by the insurer are not easy matters in marine insurance.¹⁵⁶ Accordingly, it is understandable to say that the insurers in marine insurance have to rely heavily on information from the insureds. However, it is now highly questionable whether this explanation in marine insurance is still convincing, considering the fact that there have been significant developments in the marine insurance industry in terms of the modern technology of communication, the insurers' advanced business skills, collecting material information in relation to the business and the opportunities to get assistance from the legal experts.

2.2.4.2.3. REASONS FOR DIFFERENT ATTITUDE TOWARD INSURED

What would be the reasons for this different attitude toward the insured in the courts between two countries? A difference in reputation regarding the insurers' fairness of dealing and probity in relation to their business may be the first reason. A number of reforms including the protection for the insured were more eagerly required of the American insurance industry, which had a worse reputation as compared with the English insurance industry between 1900-1940.¹⁵⁷ A second reason is related to the concept of the welfare state, which is believed to have weakened the movement of insurance law reform. Insurance contracts, which has a strong private character, had been easily ignored or omitted by welfare state programs. The fact that America did not have such a program during those days, unlike England, made it easier that the

¹⁵⁵*Federal Land Bank v. Edwards*, 1933, 262 Mich. 180, 247 N.W. 147 ; *Stipcich v. Metropolitan Life Ins. Co.*, 1928, 277 U.S. 311, 48 S.Ct. 512, 72 L.Ed. 895.

¹⁵⁶Gerace and Sandow, "Uberrimae Fidei and All-Risk Policies : Revival of a Historic Defense", (1986) Insurance Counsel Journal 154, at p. 156

¹⁵⁷See, S. Kimball, *Insurance and Public Policy*, (1960), University of Wisconsin Press.

American reformers were more concerned with regulating the private insurance than those in England.¹⁵⁸ In addition, it would appear that the concept of the "public interest" with regard to insurance, which has prevailed in America, is another reason. The view of the public interest as to insurance in America seems to have been more easily related to the issue of reform in insurance law and practice. All these reasons have made it possible that the insureds in America have been placed in a more protected position than those in England.

¹⁵⁸R. Hasson, "The Special Nature of the Insurance Contract ; A Comparison of the American and English Law of Insurance", (1984) 47 M.L.R. 505, at pp. 521-522.

CHAPTER 3. SOURCE OF DUTY OF DISCLOSURE

3.1. GENERAL CONSIDERATION

The next discussion is what is the legal basis of the duty of disclosure which stems from the principle of utmost good faith in insurance contracts? Although this may seem a rather narrow esoteric question, there are good practical reasons why this question should be considered.¹ Firstly, the remedies for the breach of this duty, in particular whether or not the action for damages is permitted, may be different, depending on the legal basis of the duty. Secondly, the extent of defendants' liability may be decided by the cause of action. For example, the question of whether or not the wrongdoing of an agent affects his principal depends on whether the cause of action is contractual or tortious etc. In addition, the question of an appropriate limitation period depends on the nature of the duty.²

These practical implications of the issue of the basis of the duty of disclosure have been discussed in recent cases such as Black King Shipping Corp. v. Massie (The Litsion Pride)³ Banque Keyser Ullmann S.A. v. Skandia (UK) Ltd⁴ and The Bank of Nova Scotia v. Hellenic Mutual War Risks Association (Bermuda) Ltd (The Good Luck)⁵

3.2. MAIN THEORIES

¹As to this question, generally see, Khurshid & Matthews, "Tracing Confusion" (1979) 95 L.Q.R. 78 ; P. Matthews, "Uberrima Fides in Modern Insurance Law" in New Foundations for Insurance Law, (ed. by F. Rose, 1987) p. 39 (hereafter P. Matthews) ; R. Davis, "The Origin of the Duty of Disclosure under Insurance Law", (1991) 4 Ins. L.J. 71

²For example, Chesworth v. Farrar [1967] 1 Q.B. 407

³[1985] 1 Lloyd's Rep. 437

⁴[1987] 1 Lloyd's Rep. 69 ; [1988] 2 Lloyd's Rep. 513; [1990] 2 Lloyd's Rep. 377

⁵[1988] 1 Lloyd's Rep. 514 ; [1989] 2 Lloyd's Rep. 238 ; [1991] 2 Lloyd's Rep. 191

There is no single theory as to the question of the basis of the duty of disclosure, which has been widely accepted and has strong support from the courts. It would appear that there has been some confusion in the judgments on this issue. In general, two schools of thought have emerged since the nineteenth century. Some insist that the existence of the duty of utmost good faith is based on the implied terms of the insurance contracts, i.e. the duty of disclosure is a contractual liability.⁶ Others maintain that the duty of disclosure is a legal duty which has been developed as a rule of law, emphasizing that it has nothing to do with the implied terms of the contract.⁷ There are others who sustain the view the basis of this duty of disclosure is the nature of the fiduciary relationship between the parties.⁸ However, this theory has weaknesses in the context of English law. Firstly, unlike in the U.S.A. where the existence of a fiduciary relationship between the insurer and the insured has been accepted by the courts in a limited way,⁹ the existence of a fiduciary relationship is not sufficiently recognized in England. Secondly, the concept of an implied covenant of good faith which can be related to the concept of

⁶*Moens v. Heyworth* (1842) 10 M. & W. 147, at p. 157 ; *Proudfoot v. Motefiore* (1867) L.R. 2 Q.B. 511, at pp. 521-522 ; *Blackburn Low Co. v. Vigors* (1886) 17 Q.B.D. 553, at pp. 578 and 583 ; (1887) 12 App. Cas. 531, at p. 539 ; *William Pickersgill & Sons Ltd. v. London and Provincial Marine and General Insurance Co. Ltd.* [1912] 3 K.B. 614, at p. 621 ; *Jester-Barnes v. Licenses & General Ins. Co. Ltd* (1934) 49 Ll.L.R. 231, at pp. 234-235 ; *Zurich General Accident and Liability Insurance Co. Ltd v. Morrison* [1942] 1 All E.R. 529, at p. 533 ; *Black King Shipping Co. v. Massie (The Litsion Pride)* [1985] 1 Lloyd's Rep. 437, at pp. 518-519 ; *The Bank of Nova Scotia v. Hellenic Mutual War Risks Association (Bermuda) Ltd (The Good Luck)* [1988] 1 Lloyd's Rep. 514, at p. 547

⁷*Joel v. Union and Crown Insurance Co. Ltd* [1908] 2 K.B. 863, at p. 886 ; *Taylor v. Eagle Star Ins. Co.* (1940) 67 Ll.L.R. 136, at p. 140 ; *Merchants & Manufacturers Ins. Co. v. Charles & John Hunt* [1941] 1 K.B. 295, at p. 313 ; *Schoolman v. Hall* [1951] 1 Lloyd's Rep. 139, at p. 142 ; *March Cabaret Club & Casino Ltd v. London Assurance* [1975] 1 Lloyd's Rep. 169, at p. 175 ; *Banque Keyser Ullmann S.A. v. Skandia (UK) Ins. Co. Ltd.* [1987] 1 Lloyd's Rep. 69, at p. 94 ; *The Bank of Nova Scotia v. Hellenic Mutual War Risks Association (Bermuda) Ltd (The Good Luck)* [1989] 2 Lloyd's Rep. 238, at p. 264 ; *Pryke v. Gibbs Hartley Cooper Ltd* [1991] 1 Lloyd's Rep. 602, at pp. 615-616

⁸P. Matthews, at pp. 42-45

⁹*Crisci v. Security Insurance Co.* 426 P.2d. 173 (1967) (Calif. S.C.) ; *Spindle v. Chubb/Pacific Indemnity Group* (1979) 152 Cal. Rptr. 776 ; *Florida Farm Bureau v. Rice* 393 So.2d. 552 (1980) (Florida C.A.)

fiduciary relationship between the insurer and the insured is much less prevalent in England than in the U.S.A.¹⁰ In view of the insufficiency of the English authority with regard to this fiduciary relationship between the parties to insurance contracts, this chapter will, therefore, focus on the first two main theories.

3.3. HISTORY OF DEVELOPMENT OF THEORIES

3.3.1. NINETEENTH CENTURY

While the existence of the duty of utmost good faith has been widely recognized, the question of the legal basis or the origin of this duty has not yet been satisfactorily established. The issue of whether it resides in the contract or relates to a common duty developed by judges remains unresolved. In *Moens v. Heyworth*¹¹, the decision was as follows:

"the policies of insurance are made on implied contract between the parties that everything material to the insurer should be disclosed."

This concept of an implied term was taken further by Cockburn C.J. in *Proudfoot v. Montefiore*¹², saying that it was an implied condition. In *Blackburn Low Co. v. Vigors*¹³, Lord Watson said ;

"It is in my opinion a condition precedent of every contract of marine insurance that the insured shall make a full disclosure of all facts materially affecting the risk which are within his personal knowledge at the time when the contract is made."

These dicta showed that the duty of disclosure was a contractual one based on the concept of an implied term in a contract of insurance, and a failure in this respect would

¹⁰M. Clarke, at p. 550

¹¹(1842) 10 M. & W. 147, at p. 157

¹²(1867) L.R. 2 Q.B. 511, at pp. 521-522.

¹³(1887) 12 App. Cas. 531, at p. 539.

amount to a breach of contract. Consequently, the remedies for the breach of the duty of disclosure in insurance contracts are not only to rescind the contract, but also to recover damages for the breach. It would appear that the underlying rationale for this view of implied term is the nature of the *uberrima fides* principle of the insurance contract itself. In other words, the insurance contract itself requires this duty of disclosure as a result of the nature of *uberrima fides*. This tendency was very clear to see in the nineteenth century.

3.3.2. TWENTIETH CENTURY

Differing accounts regarding the basis of the duty of disclosure emerged in the wake of the enactment of s. 18(1) of the M.I.A. 1906 ;

"... the assured must disclose to the insurer, before the contract is concluded."

This is because, if the basis of the duty is implied term, the duty will not arise until the contract is made. In fact, two years after the enactment of the M.I.A. 1906, a different view emerged in *Joel v. Law Union & Crown Ins. Co.*¹⁴. Although another judge expressed the view that the duty of disclosure was based on an implied term of contract¹⁵, Fletcher Moulton L.J. observed in this regard, saying that ;

"The applicant can be and is called on to answer all questions relevant to the matter in hand. But this is merely the fulfillment of a duty - it is not contractual."¹⁶

However, in *William Pickesgill v. London & Provincial Marine and General Ins. Co. Ltd*¹⁷, Hamilton J. expressed again his preference for the implied condition view ;

¹⁴[1908] 2 K.B. 863

¹⁵Vaughan Williams L.J. said "... implied contract by an applicant for a policy to make full disclosure of all facts material to the risk.", at p. 878.

¹⁶Ibid., at p. 886

¹⁷[1912] 3 K.B. 614, at p. 621

"the rule imposing an obligation to disclose upon the intending assured does not rest upon a general principle of common law, but arises out of an implied condition contained in the contract itself, precedent to the liability of the underwriter to pay."¹⁸

Nonetheless, the view of a non-contractual duty as the basis of the duty of disclosure was reinforced in a series of cases. Firstly, Scott L.J. in *Merchants and Manufacturers Ins. Co. v. John Hunt*¹⁹, maintained that the duty of disclosure was a rule of law, not a contractual one, saying ;

"I realized there were several reported cases in which learned judges have, in the course of their judgments, expressed an opinion that the duty of disclosure might be regarded as resting on an implied term, but I do not know of any case where the point had come up for actual decision. On principle it seems plain that the equitable jurisdiction to avoid a contract for misrepresentation could not rest on such a foundation... Even the common law duty of disclosure I find difficult to explain fully on the theory of its resting only on an implied term of the contract. If it did, it would not arise until the contract had been made; and then its sole operation would be to unmake the contract. Although the question has not been decided judicially, it is worthy of note that ss. 17 and 18 of the Marine Insurance Act 1906 seem to treat the twin duties of disclosing all the material facts and of misrepresenting none, as existing outside the contract and not as mere implications inside the contract; for that Act was intended to be declaratory of the Common Law"

This view of 'outside contract' as the basis of the duty of disclosure was further reinforced in *March Cabaret Club and Casino Ltd v. London Assurance*.²⁰ In this case, May J. clearly rejected the traditional view of an implied term in the contract, saying ;

"in my judgment the duty to disclose is not based upon an implied term in the contract of insurance at all; it arises outside the contract; it applies to all contracts uberrimae fidei and is not limited to insurance contracts: it also applies, for instance, to contracts of partnership, contracts of surety, certain family settlement contracts and other similar types of contractual relationship."

In 1985, this question of the basis of the duty of disclosure arose again in *Black King Shipping Corp. v. Massie (The Litsion Pride)*²¹. In this case, Hirst J. held that the duty

¹⁸Also see, C. Shawcross, *The Law of Motor Insurance*, (2nd ed., 1948), at p. 645 ; Welford and Otter-Barry, *The Law Relating to Fire Insurance*, (4th ed., 1948), at p. 5

¹⁹[1941] 1 K.B. 295, at pp. 312-313

²⁰[1975] 1 Lloyd's Rep. 169, at p. 175

of good faith in insurance contracts was to be implied as a term of the contract, saying that;

"I am prepared to hold that the duty not to make fraudulent claims and not to make claims in breach of the duty of utmost good faith is an implied term of the policy, since I prefer the authority of *Blackburn v. Vigors* in the court of Appeal to the obiter dicta in the *Merchants & Manufacturers* case."

A few years later, this issue came up again in *Banque Keyser Ullmann S.A. v. Skandia (U.K.) Ins. Ltd*²² In this case, where the question of the insurer's duty of disclosure was the main issue, the plaintiffs argued that the duty of disclosure in insurance contracts arose as an implied term of the insurance contract, and consequently sought damages for a breach of the duty of disclosure, while the defendants submitted that the basis was simply a rule of positive law. Steyn J. expressed his own view of outside contract as the basis of the duty of disclosure, saying;

"In my respectful view the body of rules, which are described as the *uberrima fides* principle, are rules of law developed by the judges. The relevant duties apply to every contract of insurance. In my judgment it is incorrect to categorize them as implied terms..."²³

The main reason for upholding the view of outside contract as the legal basis of the duty of disclosure seems to be his concern about the range of insurer's liabilities. In other words, considering the fact that Steyn J. admitted very heavy liabilities in the form of the award of damages for a breach of the duty of disclosure, he raised a question whether the Skandia Ins. Co. was only liable for the breach of the duty of disclosure or whether a following market of the insurer also were liable for the breach. If the duty was an implied term of the policy, then all insurers might be liable for Skandia's failure to disclose what it vicariously knew. If the duty was not an implied term of the contract, then the following insurers would not be liable to the banks. Not surprisingly, the

²¹[1985] 1 Lloyd's Rep. 437, at pp. 518-519

²²[1987] 1 Lloyd's Rep. 69.

²³Ibid., at p. 94

insured banks asserted that the duty of the utmost good faith arose by implication with the contract. Steyn J. concluded the basis of the duty of utmost good faith was outside contract, therefore only Skandia was liable for the breach of the duty and the subsequent insurers were not. This view of outside contract as the basis of this duty of disclosure was also accepted in the higher courts under a different name - La Banque Financiere de la Cite S.A. (formerly Banque Keyser Ullmann En Suisse S.A.) v. Westgate Ins. Co. Ltd.²⁴

There are a number of other cases which support the view of outside contract as a basis of the duty of disclosure. Macnaghten J. expressed the same view in Taylor v. Eagle Star Ins. Co. Ltd²⁵, and Cohen L.J. in Schoolman v. Hall²⁶ held that it is a common law duty (rule of law). In a recent decision, Bank of Nova Scotia v. Hellenic Mutual War Risks Association (Bermuda) Ltd (The Good Luck)²⁷, Hobhouse J. subscribed to the view of an implied term of the policy as a judicial basis of the duty, saying ;

"If one views the obligation of the utmost good faith at the time of the performance of the contract as arising from an implied term of the contract, which is the view I prefer, this conclusion is obvious."

This view, however, was rejected in the Court of Appeal with May L.J. observing that ;

"The mutual obligation of utmost good faith arose by operation of law as an incident of the contract of insurance."²⁸

If the basis of the duty of disclosure is outside contract, what then does "outside contract" mean? Is it a common law duty? Or is it a duty originating from equity? The

²⁴[1988] 2 Lloyd's Rep. 513 ; [1990] 2 Lloyd's Rep. 377

²⁵(1940) 67 Ll.L.R. 136, at p. 140. It held that "... he (the insured) was bound by the law to disclose to the insurers all the material facts."

²⁶[1951] 1 Lloyd's Rep. 139. at p. 142.

²⁷[1988] 1 Lloyd's Rep. 514, at p. 547

²⁸[1989] 2 Lloyd's Rep. 238, at p. 264.

Court of Appeal in La Banque Financiere de la Cite S.A. v. Westgate Ins. Co. Ltd implied that the duty to disclose was imposed by law arising out of equity's jurisdiction to prevent imposition; in other words, it seemed to be equitable in origin;

"... the powers of the court to grant relief where there has been a non-disclosure of material facts in the case of a contract *uberrima fides* stems from the jurisdiction originally exercised by the courts of equity to prevent imposition. The powers of the court to grant relief by way of rescission of a contract where there has been undue influence or duress stem from the same jurisdiction."²⁹

It might be said that the underlying basis of this decision comes from Lord Mansfield's rationale as to the concept of good faith in Carter v. Boehm³⁰. Lord Mansfield remarked in this momentous case ;

"Good faith forbids either party by concealing what he privately knows, to draw the other into a bargain, from his ignorance of that fact, and his believing the contrary... The reason of the rule which obliges parties to disclose, is to prevent fraud, and to encourage good faith. It is adapted to such facts as vary the nature of the contract; which one privately knows, and the other is ignorant of, and has no reason to suspect."³¹

Good faith is the basis of the duty of disclosure, and it has been said that good faith is an outstanding characteristic of equity. According to this reasoning, the duty of disclosure might be said to be one of equitable duty to exercise utmost good faith.³²

3.4. CRITICISM

As regards the legal basis of the duty of disclosure, although its existence has undoubtedly been established, there does not seem to have been a consensus either in the courts or in the literature. However, the most convincing view would seem to be outside contract. It would appear that the weakest point of the view of implied term is

²⁹[1988] 2 Lloyd's Rep. 513, at p. 550

³⁰(1776) 3 Burr. 1905

³¹Ibid., at pp. 1910- 1911

³²See, R. Davis, Ibid., at pp. 72-73,

the incompatibility with the wording of s. 18 of the M.I.A. 1906. If the basis of the duty is implied term, it cannot come into existence until the contract is made. However, this duty of disclosure is required, according to this act, before the contract is concluded. Moreover, a term must be so obvious that it goes without saying in order to become an implied term in a contract. However, a duty of disclosure cannot be said to be obvious to an insured, because the concept of a prudent insurer, the meaning of which is highly debatable, must be considered to decide the materiality in relation to the duty of disclosure. The meaning of 'prudence' is frequently related to the practice of expert evidence as to the response of the insurer in question. As to the credibility of expert evidence, Lush J. in *Horne v. Poland*³³ expressed his doubts, saying that ;

"The evidence of the underwriters on that question amounted to this : that underwriters would not accept the risk of an alien for insurance as satisfactory. One or two of the witnesses said that they did not and would not insure aliens. I am doubtful whether evidence of what individual witnesses would do was admissible..."

This view that expert evidence is not a necessarily decisive factor in determining materiality in the courts is supported in a series of cases such as *Roselodge v. Castle*³⁴, *Hemwood v. Prudential Insurance Co.*³⁵, *Reynolds v. Phoenix Assurance Co.*³⁶, *Irish National Insurance Co. v. Oman Insurance Co.*³⁷ and *Inversiones Manria S.A. v. Sphere Drake Insurance Co. (The Dora)*³⁸. Likewise, the concept of the duty of disclosure is far from clear to the insured.³⁹

³³[1922] 2 K.B. 364, at p. 365

³⁴[1966] 2 Lloyd's Rep. 113

³⁵(1967) 64 D.L.R. (2d) 715 (Spence J.'s dissenting opinion)

³⁶[1978] 2 Lloyd's Rep. 440

³⁷[1983] 2 Lloyd's Rep. 453

³⁸[1989] 1 Lloyd's Rep. 69

³⁹ For more detailed discussion as to the prudent insurer and the practice of expert evidence, see, Ch. 5 of this thesis.

It is worth re-examining some leading authorities which advocate the view of implied term of the contract. Firstly, in *William Pickersgill & Sons Ltd v. London & Provincial Marine Ins. Co. Ltd*⁴⁰, Hamilton J. said that this duty arose out of an implied condition in the contract itself.⁴¹ The reason he regarded that duty as an implied term of the contract was related to the assignee's plea that he was not responsible for non-disclosure which was made by the assignor and which became the defense by the insurer. It would appear that this argument could be resolved by reference to s. 50(2) of the M.I.A. 1906⁴² without relying on the concept of the implied term of the contract. Therefore, the foundation for the view of the implied term in this case seems to be weak.

Secondly, it would appear that the facts in *Black King Shipping Corp v. Massie, (The Litsion Pride)*⁴³ in which Hirst J. held that the duty of disclosure is an implied term of the policy seem to be irrelevant in deciding the basis of the duty. As Steyn J. pointed out⁴⁴, the actual decision of this case is concerned with the scope of the duty of the utmost good faith, not with the question of the basis of the duty. This case dealt with a failure to disclose something during the lifetime of the policy, i.e., after the conclusion of the contract, not a failure to disclose material facts before the conclusion of the contract. Therefore, this case cannot be said to be relevant in deciding the basis of the duty of disclosure in s. 18 of the M.I.A. 1906, which mainly deals with the duty of disclosure prior to conclusion of contract.

⁴⁰[1912] 3 K.B. 614.

⁴¹*Ibid.*, at p. 621.

⁴²S. 50(2) of the M.I.A. 1906 ; "Where a marine policy has been assigned so as to pass the beneficial interest in such policy, the assignee of the policy is entitled to sue thereon in his own name; and the defendant is entitled to make any defence arising out of the contract which he would have been entitled to make if the action has been brought in the name of the person by or on behalf of whom the policy was effected.

⁴³[1985] 1 Lloyd's Rep. 437, at pp. 518-519

⁴⁴*Banque Keyser Ullmann S.A. v. Skandia (U.K.) Ins. Co.* [1987] 1 Lloyd's Rep. 69, at p. 94

Apart from the above criticism of the view of implied term of the policy, the fact that this duty became a statutory one in s. 18 of the M.I.A. 1906 which is applicable to all classes of the insurance seems to support the view that the basis of the duty is outside the contract. Moreover, in the Law Reform Committee's 5th Report, the Committee expressed its own view that the basis of the duty was non-contractual, saying that;

"The effect of non-disclosure may be considered first, since it is a consequence of the general law relating to insurance contracts and does not involve any express term or condition...."⁴⁵

As regarding the view that the duty of disclosure is equitable in origin, it would appear that the rationale for this view is based on the idea that good faith, which is a basis of a duty of disclosure, is a fundamental concept of equity, and therefore the duty is of equitable origin. However, it is difficult to support this view, since the decision in *Carter v. Boehm*⁴⁶, which has been cited as a basis of this view, was made in a common law court, not in a court of equity. Therefore, the fundamental basis for this view does not seem to be strong.⁴⁷

In conclusion, the most convincing interpretation of the legal basis of the duty of disclosure is that it is not a contractual one. That is to say, it is a common law duty which is developed and imposed as a rule of law, not merely a contractual duty arising from the implied terms of the contract in question. The Australian courts have also made it clear that the duty of disclosure arises at law in a series of cases.⁴⁸ The fact that the

⁴⁵(Conditions and Exceptions in Insurance Policies), Cmnd. 62, (1957), at para. 4

⁴⁶(1776) 3 Burr. 1905, at pp. 1910-1911

⁴⁷R. Davis, *Ibid.*, at pp. 72-73

⁴⁸*Saunders v. Queensland Insurance Ltd* (1931) 45 C.L.R. 557, at pp. 563 and 568 ; *Southern Cross Assurance Co. Ltd v. Australian Provincial Assurance Ltd* (1939) 39 S.R. (N.S.W.) 174, at p. 187 ; *Claude R Ogden and Co. Pty. Ltd v. Reliance Fire Sprinkler Co.* [1973] 2 N.S.W.L.R. 7 , at pp. 21-22 ; *Kolokythas v. Federation Insurance Co. Ltd* [1980] 2 N.S.W.L.R. 663, at p. 676 ; *Khoury v. Government Insurance Office of N.S.W.* (1984) 58 A.L.J.R. 502 ; *McLeod v. S.I.M.U. Mutual Association* (1987) 4 A.N.Z. Ins. Cas., para. 60-784

duty of disclosure is clearly stipulated in s. 21 of the Insurance Contracts Act 1984 (Commonwealth) lends further weight to the view that the basis of the duty of disclosure is not a contractual one.

CHAPTER 4. DURATION OF THE DUTY AT COMMON LAW

4.1. GENERAL PRINCIPLE ON NEW CONTRACT

There are some reasons as to why the question of the exact time when the insured's duty to disclose material facts is no longer required is important in insurance contracts.¹ Firstly, it determines when the insured ceases to be under any duty to the insurer to disclose material facts of which the insured becomes aware. Secondly, it may also determine whether any facts which have later come to the insured's attention but not disclosed to the insurer are material or not, as the expiry of the duty can make those facts immaterial. In other words, the question of the time to disclose is connected with the crucial issue of whether those facts can affect the insurer's judgment in deciding whether or not to take the risk, and if so, on what terms and premium.

Considering that the purpose of the duty of disclosure is to give an assistance to the insurer in his assessment of the risk, the duty of disclosure continues throughout the negotiations, at least until the contract has been completed. In other words, the duty of disclosure mainly applies to negotiations preceding the conclusion of the contract, and full disclosure of any material fact affecting the risk in question should be made up to the time when a binding contract is concluded. Therefore, any material fact of which during the negotiations the proposed insured becomes aware, including any alteration of circumstances which brings into existence a material fact, or in consequence of which a fact previously immaterial becomes material, must be disclosed to the insurers.² In

¹Although the duty of disclosure applies to the insurers as well as the insureds, this chapter will mainly deal with the case of insureds' duty of disclosure.

²Quin v. National Assurance Co. (1839) Jo. & Car. 316, at p. 393 (Ex Ch) ; British Equitable Insurance v. Great Western Railway Co. (1869) 20 L.T. 422 ; Canning v. Hoare (1885) 1 T.L.R. 526 ; Canning v. Farquhar (1886) 16 Q.B.D. 727 ; Re Yager and Guardian (1912) 108 L.T. 38 ; Harrington v. Pearl Life Assurance Co. (1914) 30 T.L.R. 613 ; Allis-Chalmers Co. v. Maryland Fidelity and Deposit Co. (1916) 114 L.T. 433 ; Looker v. Law Union and Rock Insurance Co. [1928] 1 K.B. 554.

addition, any statement made at any stage of the negotiations which become inaccurate as a result of a change of circumstances must be amended or withdrawn by the insured.³

According to the traditional view, there is no duty to disclose supervening material facts which come to the knowledge of the insured, or any facts which become material after conclusion of the contract. The insured need not withdraw or correct the statements which do not become inaccurate until after conclusion of the contract. For instance, in *Pim v. Reid*⁴, it was held that the insurer was not discharged where the risk increased during the currency of the policy. In *Whitell v. Autocar Fire and Accident Insurance Co. Ltd*⁵, it was also held that the assured who did not become aware that his application for life insurance to another company was rejected until after the proposal had been accepted was not in breach of duty for failing to disclose the refusal. Channell J. clearly said in *Re Yarger and Guardian Assurance Co.*⁶ ;

"... the time up to which it must be disclosed is the time when the contract is concluded. Any material fact that comes to his knowledge before the contract he must disclose."

In *Niger Co. Ltd v. Guardian Assurance Co. and Yorkshire Insurance Co.*⁷, the House of Lords clearly held that there had been no non-disclosure, since non-disclosure was a matter which went only to the formation of the contract and once the contract had been concluded no further disclosure was necessary. Consequently, the materiality of a fact is decided by the circumstances at the time when the contract is concluded, not when the insurer comes on the risk in question. Therefore, for instance, a fact which was not

³*Traill v. Baring* (1864) 4 De GJ & Sm 318 ; *Re Marshall and Scottish Employers' Liability and General Insurance Co.* (1901) 85 L.T. 757 ; See, E. Ivamy, *General Principles of Insurance Law* (6th ed., 1993) Butterworths, at pp. 169-173 (hereafter Ivamy)

⁴(1843) 6 Man & G 1.

⁵(1927) 27 Ll.L.R. 418, at p. 419

⁶(1912) 108 L.T. 38, at p. 44

⁷(1922) 13 Ll.L.R. 75, at pp. 76-79 and 82

regarded as material at the time when the duty of disclosure was performed does not affect the validity of the policy although it becomes material after the contract is made. In addition, failure to disclose a rumor which at the time when the duty of disclosure was performed would have been considered material is not excused by the fact that after the contract is concluded it proves unfounded.⁸ Once the contract is concluded, the contract is subject only to ordinary good faith.⁹ This is the general common law position on this issue¹⁰ and is stipulated in s. 18(1) of the M.I.A. 1906. This principle seems to be consistent with the test of materiality for the duty of disclosure in s. 18(2), focusing on acceptance of the risk and fixing the premium.¹¹

Inevitably, the question as to which moment should be regarded as the time of the conclusion of a contract is extremely important. Section 21 of the M.I.A. 1906 clearly stipulates that ;

"A contract of marine insurance is deemed to be concluded when the proposal of the assured is accepted by the insurer, whether the policy be then issued or not; and, for the purpose of showing when the proposal was accepted, reference may be made to the slip or covering note or other customary memorandum of the contract..."

⁸Lynch v. Dunsford (1811) 14 East. 494 ; Watson v. Mainwaring (1813) 4 Taunt. 763 ; Seaton v. Burnand [1900] A.C. 135 ; Associated Oil Carriers v. Union Insurance [1917] 2 K.B. 184

⁹Of course, this position may be changed by specific provisions in the contract. This issue will be discussed later.

¹⁰Morrison v. Muspratt (1827) 4 Bing 60 ; British Equitable Insurance v. Great Western Railway Co. (1869) 20 L.T. 422 ; Iondies v. Pacific Fire and Marine Insurance Co. (1872) L.R. 7 Q.B. 517 ; Lishman v. Northern Maritime Insurance Co. (1875) L.R. 10 C.P. 179, at p. 182 ; Canning v. Farquhar (1886) 16 Q.B.D. 727, at p. 733 ; Re Marshall and Scottish Employers' Liability and General Insurance Co. (1901) 85 L.T. 757 ; Hadenfayre Ltd v. British National Insurance Society Ltd [1984] 2 Lloyd's Rep. 393, at p. 398 ; Container Transport International Ins. v. Oceanus Mutual Underwriting Association (Bermuda) Ltd [1984] 1 Lloyd's Rep. 476, at p. 486

¹¹Although this is the general common law position, however, the continuing nature of the duty of utmost good faith was recognized in Black King Shipping Corporation v. Massie (The Litsion Pride) [1985] 1 Lloyd's Rep. 437, at pp. 508-512. For the full analysis of the continuing nature of the duty of utmost good faith, see, Ch. 8 of this thesis.

In relation to the interpretation, the understanding of the formation procedure of making a contract as well as the concepts of offer and acceptance are crucial in deciding it. If the policy is initiated by a proposal or other application, the contract is concluded at the moment at which the proposal is accepted by the insurer. On the other hands, if the policy is taken out with Lloyd's underwriters, the slip is important to decide it, because slip can be regarded as a minimum requirement for the policy. In the case of a Lloyd's slip, the insured separately has a duty of disclosure to each individual underwriter, because individual underwriters initial the slip at different times and every initialing creates a separate contract. In this context, if everything material is disclosed up to the time of the initialing of the slip by the underwriter A, there is no non-disclosure so as to vitiate the policy, even though something material arising between that time and the time of executing the policy is not disclosed as far as the underwriter A is concerned. However, it does not affect the insured's duty to other underwriters. The insured should disclose to the other underwriters involved who have yet to initial the slip further material facts which arose after the time at which the slip was initialed by underwriter A, but before other underwriters initial the slip. It is because every initialing create a separate contract, therefore the duty of utmost good faith applies individually to each underwriter involved.¹²

Each underwriter must evaluate the risk by himself, irrespective of what other underwriters had been told by the insured and what they are going to do in terms of the rate of premium or inserting policy conditions. Each underwriter should rely only on what he has been told by the insured.¹³ This point is related to the recent decision of the House of Lords in Pan Atlantic Insurance Co. Ltd v. Pine Top Insurance Co. Ltd¹⁴

¹²As to the independence of each initialing, see, General Reinsurance Co. v. Forsikringsaktiebolaget Fennia Patria [1982] 1 Lloyd's Rep. 87, [1983] 2 Lloyd's Rep. 287 ; Also see, Merkin & McGee, at A.5.2-10

¹³Bank Leumi Le Israel B.M. v. British National Insurance Co. Ltd [1988] 1 Lloyd's Rep. 71

¹⁴[1994] 3 W.L.R. 677

which held that the requirement of inducement of the actual insurer is needed to avoid the contract for breach of the duty of disclosure by the insured.¹⁵

There had been arguments on the time of the conclusion of the contract especially in the case of marine insurance. In *Ionides v. Pacific Fire and Marine Insurance Co.*¹⁶, it was held that the preparation of the slip by the broker was an invitation to treat and the initialing by the first underwriter was an offer to insure to percentage stated. That offer was conditional on 100% cover being reached and an acceptance came from the broker on behalf of the insured. Therefore, this case shows that there was no contract until the slip has been fully subscribed. However, this approach was rejected in *General Reinsurance Co. v. Forsak. Fennia Patria*¹⁷, which held that the preparation of the slip was an offer, and each initialing slip was acceptance for the percentage stated. Therefore, the contract is concluded at the moment at which the slip is initialed by Lloyd's underwriters. It would appear that this judgment is compatible with the relevant section of the M.I.A. 1906.

Finally, the meaning of a new insurance contract may include cases where a change in an existing insurance policy has been made significantly enough to alter the nature of the insurance contract in question. In this case, it has been accepted that the old contract has been replaced by a new contract, and consequently the insured has a duty to disclose any facts material to the new insurance contract.¹⁸

4.2. RENEWAL OF A CONTRACT

¹⁵As to the issue of actual inducement, see. Ch. 6 of this thesis.

¹⁶(1871) L.R. 6 Q.B. 674 ; affd. (1872) L.R. 7 Q.B. 517.

¹⁷[1982] 1 Lloyd's Rep. 87 ; [1983] 2 Lloyd's Rep. 287.

¹⁸*Kensington v. Inglis* (1807) 8 East. 273, at p. 293 ; *Lishman v. Northern Maritime Insurance Co.* (1875) L.R. 10 C.P. 179, at p. 181 ; *Cornhill Insurance Co. Ltd v. Assenheim* (1937) 58 Ll.L.R. 27, at p. 29 ; Also see, M. Clarke, at pp. 557-561

Considering the purpose of the duty to disclose material facts, which is to give the insurer an opportunity to decide whether to take the contract and, if so, on what terms, including premium, this duty is required whenever the insurer has to make the same kind of decision. In England, it is widely recognized that this duty fully applies to the renewal of an insurance policy, because the renewal of an insurance policy has been regarded as the creation of a new fresh contract.¹⁹ Consequently, the insured is under a duty to disclose to the insurer any material facts which have come to his knowledge during the currency of the contract to be renewed.

Although this principle is clear, however, a practical difficulty as far as the insured is concerned remains. In the case of renewal of an insurance policy, the new proposal is mostly required by the insured, not by the insurer. Therefore, the positive duty to disclose material facts will be imposed on the insured who is most unlikely to realize that the duty of disclosure exists on each renewal, and who hardly obtains a proper warning or advice from the insurer that material facts should be disclosed.²⁰ In the U.S.A., the insured has no duty of disclosure in the case of *pro forma* renewal with no specific inquiries by the insurer.²¹

The principle of the duty of disclosure on renewal of an insurance policy, however, does not apply to the renewal of life insurance policies. It is widely accepted that a life insurance is not a periodically renewable agreement but a long-term agreement which is

¹⁹See, *Halsbury's Laws of England*, Vol. 25 (4th ed., 1978), Butterworths, at para. 491 (hereafter *Halsbury's Laws*)

²⁰However, this difficulty has been modified in view of the insured being a consumer as a result of the Statements of Insurance Practice. See, the Statement of General Insurance Practice, cl 3(a) - "Renewal notices shall contain a warning about the duty of disclosure including the necessity to advise changes affecting the policy which have occurred since the policy inception or last renewal date, whichever was the later." ; Also see, Merkin & McGee, at A.5.2.-03

²¹*Zurich General Accident & Liability Insurance Co. v. Flickinger*, 33 F. 2d, 853 (4 Cir, 1929) ; *Patrons Mutual Ins. Co. v. Rideout* 411 A. 2d, 673 (Me, 1980) ; Also see, M. Clarke, at p. 559

usually continued by the payment of a periodic premium.²² In other words, the nature of renewal of a life insurance policy is not a fresh contract, but a continuation of the original contract between the parties. It has been said that the renewal of a life insurance contract is a sort of extension. The concept of extension can be distinguished from renewal in its nature. Renewal is made by the contracting parties' agreement, whereas extension is carried out by performance of one party's (usually the insured) right. In the case of a life insurance policy, the insured has unilateral right to continue the contract, and consequently the exercise of the right to continue the contract by the insured has nothing to do with the insurer's consent. Therefore, a renewal of a life insurance policy, which is actually an extension in nature, does not require the duty of disclosure unlike a renewal of other kinds of insurance policies which are based on the insurer's consent.²³

4.3. EXCEPTIONS

4.3.1. LIFE INSURANCE & FIRE INSURANCE

Although the common law position is that the duty of disclosure expires when the contract or a renewal (except a life insurance policy) is concluded, there are some exceptions, in practice, to this principle. In other words, the date at which the duty of disclosure comes to an end can be changed by express provisions in the policy.²⁴ In particular, in life insurance policies, it is a common practice for a special clause that the commencement of the insurer's liability is to be postponed until receipt of the first premium to be inserted into the contract. It means that there is no contract until receipt of the first premium, and the insured's duty to disclose material facts is extended up to the moment that the first premium is paid.

²²C. Bennett, *Dictionary of Insurance*, (1992), Pitman, at p. 196

²³M. Clarke, at pp. 559-560

²⁴In practice, the word 'change' means 'delay' in most cases.

Locker v. Law Union & Rock Insurance Co. Ltd²⁵ shows a clear example of this. The proposer answered 'Yes' to a question 'Are you now free from disease or ailment?' in a proposal for life insurance. The insurance company sent a conditional acceptance of the risk stating that: 'If the health of the life proposed remains meanwhile unaffected, the policy will be issued on payment of the first premium.' He became ill soon after, but he did not disclose his illness. He sent the company a cheque for the first premium, but the cheque in question was dishonored on presentation. He died 4 days after the illness began. It was held that the insurers were under no duty to issue the policy as a result of the non-disclosure of that material fact, because the duty of disclosure existed down to the payment of the first premium.²⁶

The link between the commencement of the insurer's liability and the payment of the first premium is also found in a fire insurance policy.²⁷ In addition, the duty to disclose material facts which increase the risk in question during the currency of the policy is, in practice, imposed on the insured in the case of a fire insurance policy.²⁸ However, it would appear that the nature of this duty additionally imposed on the insured in a fire insurance policy is usually a promissory warranty rather than the principle of utmost good faith.

4.3.2. OTHER EXCEPTIONS

The insured's duty of disclosure may also be extended by an express clause in a policy stating that the insurer's liability is to be postponed until actual delivery of the policy to the insured. In other words, the contract will not have been completed until the policy is

²⁵[1928] 1 K.B. 554

²⁶Also see, British Equitable Ins. Co. v. Great Western Rly Co. (1869) 20 L.T. 422 ; Canning v. Farquhar (1886) 16 Q.B.D. 727 ; Harrington v. Pearl Life Co. (1914) 30 T.L.R. 613

²⁷Re Yarger and Guardian Assurance Co. Ltd (1912) 108 L.T. 38

²⁸Shaw v. Robberds (1837) 6 Ad. & El. 75 ; Glen v. Lewis (1853) 8 Exch. 607

actually delivered to the insured. Therefore, the duty of disclosure will exist longer.²⁹ Other exceptions can be found in a marine insurance policy (voyage policy). In a case where the vessel changes, deviates or delays its voyage³⁰, a 'held covered' clause is usually applied in order to continue the cover for the insured. One of the conditions for the 'held covered' clause to be operated is the requirement for the insured to disclose immediately these things to the insurer.³¹ In this sense, the duty of disclosure exists beyond conclusion of the contract.³²

In addition, the insured's duty of disclosure may be revived even after completion of the contract where the insured tries to alter some of the terms as to his benefit. In this case, the insured has to disclose any material facts which relate to those alterations, although the insured has become aware of these facts after the contract is concluded.³³ A limited duty of disclosure is also applied even after conclusion of the contract when there is a change which is not significant enough to alter the nature of the contract but affects the risk in question.³⁴ In conclusion, the duty of disclosure is generally required prior to conclusion of the contract. However, it is still needed when the insured has an express or implied duty to disclose material facts to enable the insurer to make a decision.

²⁹Allis Chalmers Co. v. Maryland Fidelity and Deposit Co. (1916) 114 L.T. 433

³⁰As to the effects of these, see, ss. 43-49 of the M.I.A. 1906

³¹For example, Clause 2 of the Institute Voyage Clause Hulls ; Overseas Commodities Ltd v. Style [1958] 1 Lloyd's Rep. 546, at p. 559 ; Liberian Insurance Agency Inc. v. Mosse [1977] 2 Lloyd's Rep. 560, at p. 568 ; Black King Shipping Co. v. Massie (The Litsion Pride) [1985] 1 Lloyd's Rep. 437, at p. 511

³²For more detailed discussion, see Ch. 8 of this thesis

³³Sawtell v. Loudon (1814) 5 Taunt 359 ; Lishman v. Northern Maritime Insurance Co. (1875) L.R. 10 C.P. 179 ; Re Marshall and Scottish Employers' Liability and General Insurance Co. Ltd (1901) 85 L.T. 757

³⁴Lishman v. Northern Maritime Insurance Co. (1875) L.R. 10 C.P. 179 ; M. Clarke, at p. 558

CHAPTER 5. INTERPRETATIONS OF THE TEST OF MATERIALITY - DUTY OF DISCLOSURE BY THE INSURED¹ -

5.1. GENERAL CONSIDERATION

5.1.1. INTRODUCTION

Contracts of insurance are an outstanding example of contracts *uberrimae fidei*. It has been said that this nature of insurance contracts is mainly attributable to the fact that the insured is in a better position to acquire the material facts in making contracts, and the insurer might be misled in calculating the risk by the insured's non-disclosure of material facts. This special nature of insurance contracts (utmost good faith) imposes a duty to disclose all material facts and circumstances² on the insured, and the insurer is entitled to rescind the policy, if that is the insurer's wish, in the case of the insured's breach of this duty of disclosure.³ This is an absolute common law right.

The duty of disclosure does not extend to every fact and circumstance, but only to such facts and circumstances as are material in the particular case.⁴ Therefore, there is no requirement for the insured to disclose immaterial circumstances. But how does the insured know what facts or circumstances are material? The answer to this question would be the test of materiality and could mean the difference between success and

¹This chapter will focus on the test for materiality in the duty of disclosure by the insured. Another aspect of the test of materiality as to the insurer's duty of disclosure which is required from the nature of reciprocity of the duty of disclosure will be discussed in Chapter 7 of this thesis.

²The words "facts" and "circumstances" are here interchangeable, although the term of "circumstances" has been more frequently referred to in many cases and is prescribed in s. 18(2) of the M.I.A. 1906.

³Ss. 18(1) and 20(1) in M.I.A. 1906

⁴*Ionides v. Pender* (1874) L.R. 9 Q.B. 531, at p. 539 ; *The Bedouin* [1894] P. 1, at p. 12, saying that the insured is bound to tell the underwriter, not every fact, but the material facts.

failure in securing valid insurance cover. In other words, the scope of this duty of disclosure is delimited by the concept of materiality.

In general, the wide-ranging nature of this duty of disclosure, which has been prevailing in insurance contracts in England, has been the subject of the severe academic criticism for a long time. This doctrine of duty of disclosure in insurance contracts has been regarded as rigid, inflexible and out of date. The expression '*contracts uberrimae fidei*' has been too frequently and almost indiscriminately used by insurers and judges as an excuse for ignoring insurance claims. Consequently, the insured's duty of disclosure of material facts becomes one of the most onerous burdens on the insured in insurance contracts.

Among the criticisms of the range of the duty of disclosure, the criticism of the current test of materiality has been the primary one. This is because the test of materiality is an indispensable part of the duty of disclosure, since the analysis and determination of the nature of the circumstances which are subject to the duty of disclosure are crucial factors in discharging the insured's duty of disclosure. There is no doubt that the test of materiality, in practice, has been mainly applied and interpreted in favor of the insurer, and has been the subject of a certain amount of judicial disagreements such as the standard for determining materiality and the degree of influence of the undisclosed facts etc.⁵

⁵J. Birds, "The Reform of Insurance Law" [1982] J.B.L. 449 ; F. Achampong, "Uberrima Fides in English and American Insurance Law : A Comparative Analysis" (1987) 36 I.C.L.Q. 329 ; H. Yeo, "Uberrima Fides - Reciprocity of Duty in Insurance Contracts", (1988) 2 Review of International Business Law 271 ; "Of reciprocity and remedies - duty of disclosure in insurance contracts", (1991) 11 Legal Studies 131 ; R. Hasson, "Uberrima Fides in Insurance Law - A Critical Evaluation" (1969) 32 M.L.R. 615 ; "The Special Nature of the Insurance Contract : A Comparison of the American and English Law of Insurance" (1984) 47 M.L.R. 505 ; "Good Faith in contract Law - Some Lessons from Insurance Law" (1987-1988) 13 Can. Bus. L.J. 93 ; B. Harnett, "The Doctrine of Concealment : A Remnant in the Law of Insurance" (1950) 15 Law and Contemp. Prob. 391 ; Also see, A. Diamond, "The law of marine insurance -has it a future?" [1986] L.M.C.L.Q. 25, at p. 33 ; H. Brooke, "Materiality in insurance contracts", [1985] L.M.C.L.Q. 437

5.1.2. DEFINITION OF MATERIALITY⁶

In the early nineteenth century, Sir James Mansfield C.J. explained in *Willes v. Glover*⁷ that materiality was an opportunity of exercising insurer's judgment in settling the premium. Then, Gibbs C.J. in *Durrell v. Bederley*⁸ said that the meaning of materiality was concerned with whether particular facts, if disclosed to an underwriter, would make a difference as to the amount of premium. This definition was repeated in a similar expression by Lord Tenterden C.J. in *Rickards v. Murdock*⁹, saying that had the facts been disclosed, they would have influenced the mind of the underwriter in deciding upon what terms he would accept the risk.

In the mid-nineteenth century, writers were becoming concerned about the unfair burden which might be placed, in relation to the test of materiality in the duty of disclosure, on the insured. John Duer maintained that a non-disclosure was material if it not only induced the particular insurer in the making of the insurance contract, but also actually affected the risk to be insured against.¹⁰ He said ;

"Of the materiality of facts, as tending to show the true nature of the risk that he desired to be covered, the assured ought to be, may be, and usually is, a competent judge. Hence, it is just to require their disclosure, and not allow his ignorance or inadvertence as an excuse for the omission. But there is no process of reasoning that can enable the assured to judge the possible or probable influence on the mind of the underwriter of circumstances that, in reality, are extraneous to the risk."¹¹

⁶Generally see, G. Spencer Bower, *The Law Relating to Actionable Non-Disclosure and Other Breach of Duty in relation of Confidence, Influence and Advantage*, (2nd ed. by A. Turner and R. Sutton, 1990), Butterworths, at pp. 32-33 (hereafter Bower)

⁷(1804) 1 Bos. P.N.R. 14, at p. 16

⁸(1816) Holt N.P. 283, at p. 286

⁹(1830) 10 B. & C. 527, at p. 540

¹⁰*The Law and Practice of Marine Insurance* (1846) Vol. II, at pp. 388-391

¹¹*Ibid.*, at p. 390

According to his analysis of materiality, the duty of disclosure was strongly related to those facts which affected the intrinsic nature of the risk. In other words, materiality is limited to the risks insured against. Joseph Arnould argued that the risk should be given a wider meaning so that the duty extended to anything which would probably influence the insurer's decision, stating that the non-disclosure was material if it induced the particular insurer to enter the contract.¹² Later, Professor Parsons, who seemed to be influenced by Duer's view which focused on relieving the insured from the unfair burden which would otherwise be imposed on him, proposed a new definition, saying that "Would a *rational insurer*, governing himself by the principles and calculations commonly applied to policies and risks, have regarded these facts as bearing on those risks?"¹³ According to Parsons's formulation of the test of materiality, all should be disclosed which would affect the judgment of a rational underwriter, and materiality is not limited to the risks considered in their own nature.

It would appear that the definition of materiality proposed in *Ionides v. Pender*¹⁴, from which the concept of the prudent insurer was introduced for the first time in the courts, was based on Parsons' formulation which rejected the view that materiality was to be decided solely by the actual insurer's standard. Blackburn J., who delivered the judgment of this case, defined materiality as follows ;

"... all should be disclosed which would affect the judgment of a rational underwriter governing himself by the principles and calculations on which underwriters do in practice act..."¹⁵

¹²*A Treatise on the Law of Marine Insurance and Average* (1848) Vol. I, at p. 536

¹³*A Treatise on the Law of Marine Insurance and General Average* (1868), Vol. I., at pp. 495-496

¹⁴(1874) L.R. 9 Q.B. 531

¹⁵*Ibid.*, at p. 539

This new test of materiality became a substantive requirement. The insurer had to establish that the non-disclosure was material in the sense that it would have affected the judgment of a rational or prudent insurer in deciding whether to take the risk, and it was not sufficient that the actual insurer relied on a non-disclosure merely because the insured's non-disclosure of the relevant fact had induced him to contract with the insured. The current definition of materiality in s. 18(2) of the M.I.A. 1906 - 'Every circumstance is material which would influence the judgment of a prudent insurer in fixing the premium or determining whether he will take the risk.' - was drafted under the direct influence of the decision in *Ionides v. Pender*, and it has been supported in a series of decisions.

The decision in the Court of Appeal in *Container Transport International Inc. v. Oceanus Mutual Underwriting Association (Bermuda) Ltd*¹⁶ (hereafter C.T.I. case) clearly showed that if a circumstance would influence the judgment of a prudent underwriter in relation to the special terms in insurance contracts such as an excess or an exclusion other than the premium, it is also a material circumstance which should be disclosed.

From the above section, it is very clear that the judgment of a prudent and experienced insurer, not that of the insured¹⁷, nor even that of the insurer in question¹⁸, is a decisive yardstick to determine whether a fact is material or not. However, the interpretation of this section has created a considerable amount of legal disagreement. In other words, the courts' decisions as to some crucial issues such as the standard of the "prudent insurer",

¹⁶[1984] 1 Lloyd's Rep. 476, at p. 529

¹⁷*Lindenau v. Desborough* (1828) 8 B. & C. 586, at pp. 592 and 593 ; *Bates v. Hewitt* (1867) L.R. 2 Q.B. 595, at p. 608 ; *London Assurance v. Mansell* (1879) 11 Ch. D. 363, at p. 368 ; *Re Yager and Guardian* (1912) 108 L.T. 38, at pp. 44-45

¹⁸*Glasgow Assurance v. Symondson* (1911) 104 L.T. 254, at p. 257

the meaning of the word "influence" and "judgment", and the connection between the risk in question and the undisclosed material facts have not yet been satisfactorily settled.¹⁹

This provision was interpreted in detail by the Court of Appeal in *C.T.I.* case. It has been said that this case was the first one which analyzed with full scale the question of the degree to which a prudent insurer would have been influenced in his conduct had he been in possession of the relevant facts, although the question of the standard of a prudent insurer had been discussed since middle of the nineteenth century.²⁰ The decision in this case has become the basis of all following discussions as to the question of materiality. This decision, however, has met with a lot of criticism and been regarded as a very disappointing one. It would appear that it has aggravated the situation, which has already been criticized in terms of 'fairness or equality' between the parties, by reinforcing the insurer's position even further. This disappointing but leading authority on this issue was relied on in a series of decisions.

It would appear that the principle of the duty of disclosure extends to not misleading the insurer by disclosure of material facts so that he is induced to take the risk when he would not otherwise have taken it, or so that he is induced to fix a lower premium

¹⁹See, *Tate v. Hyslop* (1885) 15 Q.B.D. 368, at p. 379 ; *Associated Oil Carriers Ltd v. Union Insurance Society of Canton Ltd* [1917] 2 K.B. 184, at p. 192 ; *Becker v. Marshall* (1922) 12 Ll.L.R. 423, at p. 414 ; *Mutual Life Ins. Co. of New York v. Ontario Metal Products Co. Ltd* [1925] A.C. 344, at pp. 350-352 ; *Zurich General Accident v. Morrison* [1942] 2 K.B. 53, at p. 60 ; *Lambert v. Co-operative Insurance Society Ltd* [1975] 2 Lloyd's Rep. 485, at pp. 487-491 ; *Berger v. Pollock* [1973] 2 Lloyd's Rep. 442, at p. 463 ; *The C.T.I. case* [1982] 2 Lloyd's Rep. 178, at pp. 187-189, [1984] 1 Lloyd's Rep. 476, at pp. 492 and 511 ; *Pan Atlantic Insurance Co. v. Pine Top Insurance Co. Ltd* [1992] 1 Lloyd's Rep. 101, at pp. 112-113, [1993] 1 Lloyd's Rep. 496, at pp. 506-508, [1994] 3 W.L.R. 677, at pp. 695-705 and 721-728 ; *St. Paul and Marine Insurance Company (U.K.) Ltd v. McConnell Dowell Constructors Ltd* (1995) 45 Construction Law Reports 89

²⁰Evans L.J. in the Court of Appeal in *St. Paul Fire and Marine Insurance Co. Ltd v. McConnell Dowell Constructors Ltd* (1995) 45 Construction Law Reports 89 said that the crucial aspect of the *C.T.I.* decision was not the definition of materiality but the rejection of the actual underwriter as playing any part in the process of establishing his own right to avoid the policy. The analysis of this will be made later in this chapter.

instead of a higher premium. This element of inducement is surely one of the key points in the duty of disclosure, although, over the years, this element had been denied in the courts. However, the House of Lords in Pan Atlantic Insurance Co. v. Pine Top Insurance Co. Ltd. (hereafter Pan Atlantic case)²¹ fully endorsed this long-standing argument - the requirement of the particular insurer's inducement in the making of the contract - as a separate requirement in order to avoid the policy in recent decisions, although some controversial aspects still remain such as the interpretation of the degree of influence and the question of presumption of inducement in application of this new requirement. In the Court of Appeal in St. Paul and Marine Insurance Co. Ltd v. McConnell Dowell Constructors Ltd (hereafter St. Paul case)²², the judgment of the House of Lords in Pan Atlantic case was approved, and the presumption of inducement was in fact applied in decision.

5.1.3. S. 18 OF M.I.A. 1906 AND GENERAL APPLICATION

In insurance contracts, in particular in non-marine insurance contracts, it is not unusual to introduce some special provisions which may, expressly or implicitly, define, regulate, extend or limit the scope of duty of disclosure either in the policy itself or in the documents which are incorporated. For example, the insured may be asked expressly to make an answer to an explicit question made by the insurer, and the disclosure made in relation to answering to the question will then be a representation of fact; furthermore, the strict truth of the fact thus represented, even though it is not a material fact, is often made an express condition of the contract.²³

²¹[1994] 3 W.L.R. 677

²²(1995) 45 Construction Law Reports 89

²³Anstey v. British Natural Premium Life Association Ltd (1908) 24 T.L.R. 594 ; Dawsons Ltd. Bonnin [1922] 2 A.C. 413 ; Australian Widows' Fund Life Assurance Society v. National Mutual Life Association of Australia Ltd [1914] A.C. 634 ; Halsbury's Laws, at paras. 379-380

However, apart from these special stipulations in the contract about the requirement or the scope of the duty of disclosure, the rules for determining what facts are material and should be disclosed by the insured have been codified as far as marine insurance is concerned. It has been fully acknowledged that these rules as to materiality in the M.I.A. 1906 are a codification of common law. Therefore, these rules can also be applied to non-marine insurance.²⁴ This view was confirmed by Lord Mustill in the *Pan Atlantic* case²⁵, saying ;

"Although the issues arise under a policy of non-marine insurance it is convenient to state them by reference to the Marine Insurance Act 1906 since it has been accepted in argument, and is indeed laid down in several authorities, that in relevant respects the common law relating to the two types of insurance is the same, and that the Act embodies a partial codification of the common law."

5.1.4. TEST OF MATERIALITY IN MISREPRESENTATION

It is accepted that the rules for determining what facts are material ones which should be disclosed by the insured have the same meaning, as these rules are applied to the case of misrepresentation.²⁶ Therefore, every material representation made prior to the contract by the proposer must be true and if the evidence shows that a misrepresentation made by him for the contract is one which would influence the judgment of a prudent insurer in

²⁴*Joel v. Law Union & Crown Ins. Co. Ltd* [1908] 2 K.B. 863, at p. 883 ; *Cantiere Meccanico Brindisino v. Janson* [1912] 3 K.B. 452, at p. 467 ; *Locker & Woolf Ltd v. Western Australian Insurance Co. Ltd* [1936] 1 K.B. 408, at p. 415 ; *Godfrey v. Britannic Assurance Co. Ltd* [1963] 2 Lloyd's Rep. 515, at p. 528 ; *Babatsikos v. Car Owners' Mutual Insurance Co. Ltd* [1970] 2 Lloyd's Rep. 314, at p. 325 ; *March Cabaret Club & Casino Ltd v. London Assurance* [1975] 1 Lloyd's Rep. 169, at p. 174 ; *Lambert v. Cooperative Insurance Sy. Ltd* [1975] 2 Lloyd's Rep. 485, at pp. 487 and 493 ; *Highlands Insurance Co. v. Continental Insurance Co.* [1987] 1 Lloyd's Rep. 109, at pp. 113-114 ; *Pan Atlantic Insurance Co. v. Pine Top Insurance Co. Ltd* [1994] 3 W.L.R. 677, at p. 683. ; Also see, Road Traffic Act 1988 s. 151 (9)(b)

²⁵[1994] 3 W.L.R. 677, at p. 683

²⁶Compare s. 18 (1)(2) with section 20 (1)(2) in the M.I.A. 1906. S. 18 (2) sets out the rule for materiality in the duty of disclosure in a similar expression to the one defined in the case of misrepresentation in s. 20 (2) ; Also see, Road Traffic Act 1988 s. 151 (9) ; *Mutual Life Ins. Co. of New York v. Ontario Metal Products Co. Ltd* [1925] A.C. 344 ; *Highlands Insurance Co. v. Continental Insurance Co.* [1987] 1 Lloyd's Rep. 109

fixing the premium, or determining whether he will take the risk, the insurer is entitled to rescind the policy.

5.2. YARDSTICK FOR TEST OF MATERIALITY

5.2.1. INTRODUCTION

The first question in relation to the discussion of the test of materiality in non-disclosure is "What should be a criterion for determining the materiality of information?" The answer to the question of whether or not a fact undisclosed is material might be entirely different, depending on the type of test to be applied to the undisclosed fact in question in order to decide whether it should have been disclosed. It is submitted that there are four tests for determining materiality - a particular insured test, a prudent insurer test, a reasonable insured test and a particular insurer test -. Each test has both its strong points and weak points. Although s. 18(2) of the M.I.A. 1906 clearly refer to "a prudent insurer test", it is worth analyzing the other tests because "a prudent insurer test" has met with a lot of criticism and the requirement for reform of the current test is increasing.²⁷

5.2.2. A PARTICULAR INSURED TEST²⁸

This test regards the actual opinion of the insured as to the materiality of a fact as a decisive yardstick for the purpose of determining materiality. In other words, the materiality of information is decided by what and how the insured in question thought about the undisclosed fact. This is a purely subjective test. This test seems to be very close to the principle of *uberrima fides*, which requires the utmost good faith of the

²⁷As far as the test of the particular insurer, it will be discussed in Ch. 6 of this thesis, which becomes a separate and independent requirement by the decisions in the Pan Atlantic case.

²⁸It is clear that the terms 'particular' and 'actual' are interchangeable.

contracting party itself.²⁹ It would appear, however, that this test is too much in favor of the insured. Everything depends on the idiosyncrasy of each insured and it is very difficult for the insurer to predict the mind of the insured. This test has been rejected by the courts in many cases and no case has regarded the response of the actual insured himself as a decisively relevant factor to determine materiality. The reasons why the particular insured's opinion as to the materiality of a fact cannot be accepted as a yardstick were explained by Bayley J. in *Lindenau v. Desborough*³⁰ saying ;

"The proper question is 'whether any particular circumstance was in fact material?' and not whether the party believed it to be so. The contrary doctrine would lead to frequent suppression of information, and it would often be extremely difficult to show that the party neglecting to give the information thought it material."

In addition, Mellor J. also said in *Bates v. Hewitt*³¹ ;

"I cannot help thinking that to enable a person proposing an insurance to speculate upon the maximum or minimum of information he is bound to communicate, would be introducing a most dangerous principle into the law of insurance"

It is clear, then, that the question is not whether a certain individual believed a particular fact to be material. In other words, the insured's pure subjective opinion as to whether the undisclosed fact is material or not has a difficulty to be regarded as a sole yardstick in determining materiality. Accordingly, one inevitable consequence remains - the principle of *uberrima fides* is, therefore, to an extent misleading, because an insured

²⁹See, s. 21 of the new Insurance Contracts Act 1984 (Commonwealth) in Australia.

³⁰(1828) 8 B. & C. 586, at p. 592

³¹(1867) L.R. 2 Q.B. 595, at p. 608 ; Also see *London Assurance v. Mansel* (1879) 11 Ch. D. 363, at p. 368 ; *Brownlie v. Campbell* (1880) 5 App. Cas. 925, at p. 954 ; *Joel v. Law Union and Crown Insurance Co.* [1908] 2 K.B. 863, at p. 884 ; *Re Yager and Guardian Assurance Co.* (1912) 108 L.T. 38, at p. 44 ; *Godfrey v. Britannic* [1963] 2 Lloyd's Rep. 515, at p. 529 ; *Roselodge Ltd v. Castle* [1966] 2 Lloyd's Rep. 113, at pp. 129-131

might believe in all honesty that he complied with the duty of good faith, and yet might fail to discharge the duty of disclosure.³²

5.2.3. A PRUDENT INSURER TEST³³

5.2.3.1. GENERAL CONSIDERATION

Section 18(2) of the M.I.A. 1906, which has been said to be influenced by the decision in *Ionides v. Pender*³⁴, which introduced for the first time in the courts the principle of "a prudent (rational) insurer", adopts the test of a prudent insurer. It is clear from s. 18(2) that materiality is not a question of belief or opinion tested subjectively and the insured does not discharge his duty by a full and frank disclosure of what he believes to be material, however honest his belief; he must go further and disclose any fact which a prudent insurer would have thought material. The test of a prudent insurer has been supported in a series of decisions and is now regarded as a prevailing standard for determining materiality of a non-disclosure. For example, Lord Salvesen in *Mutual Life Insurance Co. New York v. Ontario Metal Products Co. Ltd.*³⁵ said ;

"It is a question of fact in each case whether if the matters concealed or misrepresented had been truly disclosed they would, on a fair consideration of the evidence, have influenced a reasonable insurer to decline the risk or to have stipulated for a higher premium."³⁶

³²MacGillivry & Parkington, at para. 661

³³Sometimes the word "reasonable insurer" took the place of the "prudent insurer". See, *Mutual Life Ins. Co. v. Ontario Metal Products* [1925] A.C. 344, at p. 351 ; *Zurich General Accident v. Morrison* [1942] 2 K.B. 53, at p. 58 ; Also some cases used the term of "rational insurer". See, *Ionides v. Pender* (1874) L.R. 9 Q.B. 531, at p. 539 ; *Rivaz v. Gerussi* (1880) 6 Q.B.D. 222, at p. 229. However it seems that these phrases are interchangeable. See, *Associated Oil Carriers v. Union Insurance of Canton* [1917] 2 K.B. 184, at p. 192 ; MacGillivray & Parkington, at p. 267

³⁴(1874) L.R. 9 Q.B. 531

³⁵[1925] A.C. 344, at pp. 351-352

³⁶See also, *Zurich General Accident and Liability Insurance Co. Ltd v. Morrison* [1942] 2 K.B. 53, at p. 60

More recently, this prudent insurer test was accepted in a succession of cases : *Lambert v. Co-operative Insurance Society Ltd*³⁷, The C.T.I. case³⁸, *Highlands Insurance Co. v. Continental Insurance Co.*³⁹, the Pan Atlantic case⁴⁰ and the St. Paul case.⁴¹

5.2.3.2. RATIONALE OF A PRUDENT INSURER TEST

Although the prudent insurer test has been accepted in a series of decisions, the reasons why this test should be chosen as a standard do not seem to have been discussed in detail. However it is not impossible to detect these reasons from the background of the judgments. The purpose of the prudent insurer test is to prevent an insurer in question from avoiding the policy on the ground of non-disclosure of a fact which is judged as immaterial by the prudent insurer and which an insured might very reasonably fail to disclose, having the knowledge of the standards of the insurance business and the normal practice. It has been said that the adoption of the prudent insurer test provides an objective and ascertainable test, at least in theory, independent of the idiosyncrasies of the actual insurer in question.⁴² Common law is now accustomed to judging the contracting parties' conduct according to the standards of the "reasonable man". This concept of reasonableness or prudence, if it applies to insurance contracts, can remove the idiosyncrasies of individual and actual underwriters, which might be an obstacle to achieving a pattern of consistency in the reported case law which the insurance market

³⁷[1975] 2 Lloyd's Rep. 485, at pp. 491 and 493

³⁸[1984] 1 Lloyd's Rep. 476, at pp. 492, 510, 511, and 529

³⁹[1987] 1 Lloyd's Rep. 109, at p. 113-114

⁴⁰[1994] 3 W.L.R. 677, at pp. 682, 695-705 and 714

⁴¹(1995) 45 Construction Law Reports 89

⁴²N. Fancourt and A. Gouge, "The English Law of Non-Disclosure Revised - The House of Lords Decision in Pan Atlantic v. Pine Top -", [1994] 10 International Insurance Law Review 392, at p. 393 (hereafter Int'l Ins. L.R.)

would be able to follow. Likewise, the adoption of a prudent insurer test promotes prudent standards and thus lessens the risk of insurance insolvencies.⁴³

In the mid-nineteenth century, the view that evidence from an expert witness should be admissible on the question of materiality of a non-disclosure was becoming more and more accepted. The appearance of the concept of "a prudent insurer" seems to be related to this practice. If the judgment of a particular insurer is a standard for determining materiality, the admissibility of the evidence from experts will create difficulties when the actual insurer's subjective judgment is different from an idealized prudent insurer's objective judgment. Therefore, the test of a prudent insurer was needed to comply with this practice (expert evidence).

In addition, another practical reason which is mainly in favor of the insurer required this test. This test relieves an insurer in question, basing the defense on alleged non-disclosure of a material fact, from the burden of proving that he was actually influenced by the undisclosed facts or circumstances in the making of the insurance contract. However, this view is now modified by the decisions of the House of Lords in the *Pan Atlantic* case and of the Court of Appeal in the *St. Paul* case which held that to avoid a contract for non-disclosure of a material circumstance the insurer in question had to show that he had actually been induced by the non-disclosure to enter into the policy on the relevant terms.⁴⁴ However, the insurer could be relieved again in practice from the burden of proof of actual inducement by the non-disclosure as a result of the wide application of the presumption of inducement. As a result of the presumption of inducement, it is the insured who should prove that there was no actual inducement and the insurer would have entered into the contract anyway. Therefore, the underlying

⁴³H. Brooke, *Ibid.*, at pp. 440-441 ; H. Bennett, "The duty to disclose in insurance law", (1993) 109 L.Q.R. 513, at p. 515 ; M. Clarke, at pp. 562-569

⁴⁴[1994] 3 W.L.R. 677, at pp. 681, 712, 714 and 732. ; (1995) 45 Construction Law Reports 89 ; Also see *Berger v. Pollock* [1973] 2 Lloyd's Rep. 442, at p. 463

intention of the introduction of the additional requirement of inducement could be overshadowed by the presumption of inducement.⁴⁵

5.2.3.3. CONTENTS OF A PRUDENT INSURER TEST

5.2.3.3.1. MEANING OF PRUDENT INSURER

The meaning of the term 'prudent insurer' was discussed by Atkin J. in Associated Oil Carriers Ltd. v. Union Insurance Society of Canton Ltd.⁴⁶, although few cases have sought to define its meaning. Atkin J. said in this case ;

"I think that this standard of prudence indicates an underwriter much too bright and too good for human nature's daily food. There seems no good reason to impute to the insurer a higher degree of knowledge and foresight than that reasonably possessed by the more experienced and intelligent insurers carrying on business in that market at that time."⁴⁷

Also, according to Lord Radcliffe in Davis Contractors Ltd v. Fareham U.D.C.⁴⁸, the prudent insurer is no more than the anthropomorphic conception of the standard of professional underwriting which the court found it appropriate to uphold. It is very clear that s. 18(2) of the M.I.A. 1906 applies to both marine insurance and all non-marine insurance. In other words, this prudent insurer test becomes the general principle in all insurance contracts. However, it must not be supposed that the judgment of the prudent insurer would be the same in all types of insurance. Underwriters of one kind of risk may be influenced by a particular detail that would not influence those writing other kinds of risk. As to this question, Scrutton L.J. showed an example in Glicksman v. Lancashire and General Assurance Co. Ltd.⁴⁹, that in marine insurance the fact that

⁴⁵For more detailed discussion, see the Chapter 6 of this thesis.

⁴⁶[1917] 2 K.B. 184

⁴⁷Ibid., at p. 192

⁴⁸[1956] A.C. 696, at p. 728

⁴⁹[1925] 2 K.B. 593, at p. 608

another underwriter had refused to accept the risk was immaterial⁵⁰, whereas this was certainly material and should be disclosed to the insurer in non-marine insurance.⁵¹ It seems to be appropriate that some words such as '*in that type of insurance*' should be added after the term "a prudent insurer" in s. 18(2) of the M.I.A. 1906.⁵²

It may be argued that the phrase '*having regard to the class and character of the transaction contemplated*' should be also considered in interpretation of this provision. The purpose of this phrase is to emphasize the fact that the materiality of the undisclosed fact is not necessarily related to the actual contemplated transaction itself, but is related to transactions of the same class as the contemplated transaction. The materiality or otherwise of a circumstance should be constant. Consequently, it is crucial for establishing materiality to show a logical connection between the undisclosed fact and a class of transactions to which the proposed transaction belongs.⁵³

5.2.3.3.2. TIME TO DECIDE MATERIALITY

The materiality of a fact is determined, using the general practice and opinion of the insurers, at the time that the duty of disclosure has to be performed, in other words, at the time at which the insurance contract becomes binding.⁵⁴ Therefore, the materiality of a fact is determined by the circumstances which are existing at the time when it should have been disclosed to the insurers and not by the events which may subsequently

⁵⁰Glasgow Assurance v. Symondson (1911) 104 L.T. 254 ; North British Fishing Boat Insurance Co. Ltd v. Starr (1922) 13 Ll.L.R. 206

⁵¹Re Yager and Guardian Ass. Co. (1912) 108 L.T.38 ; Dent v. Blackmore (1927) 29 Ll.L.R. 9 ; Broad and Montague Ltd v. South East Lancashire Insurance Co. Ltd (1931) 40 Ll.L.R. 328 ; Locker & Woolf v. W. Australian Ins. Co. [1936] 1 K.B. 408

⁵²MacGillivray & Parkington, at para. 658

⁵³Ionides v. Pender (1874) L.R. 9 Q.B. 531, at pp. 538-539 ; Tate v. Hyslop (1885) 15 Q.B.D. 368, at p. 376 ; Bower, at pp. 32-34

⁵⁴Fraxis Time & Co. v. Sea Insurance Co. Ltd (1898) 3 Com. Cas. 229, at pp. 235-236 ; Seaton v. Burnard [1900] A.C. 135, at p. 140

transpire.⁵⁵ It is clear from this principle that if a fact is immaterial at that date, and only becomes material afterwards, the insured is not in breach of the duty for failing to disclose it.⁵⁶ On the other hand, if the fact was material at that date, its non-disclosure is a ground for avoiding the policy, although it afterwards proves to be immaterial.⁵⁷

5.2.3.3.3. CONNECTION BETWEEN LOSS AND FACT UNDISCLOSED

In determining materiality, the question is whether the fact undisclosed would have been material in influencing the mind of a prudent insurer, not whether the loss is the result of the undisclosed fact. If a prudent insurer is influenced by the knowledge of the fact undisclosed in deciding whether he will reject the risk or he will accept it only at a higher premium rate, that fact is material, although it may not even remotely contribute to the contingency in question.⁵⁸ Therefore, the proof of any connection between the loss and the material fact which is not disclosed to the insurer is unnecessary.⁵⁹ However, there has been criticism that this practice and interpretation sometimes create hardship and an onerous burden upon the insured.

5.2.3.4. MATERIALITY WHEN SPECIFIC INQUIRIES ARE MADE

In non-marine insurance, some provisions which affect the disclosure of information, by defining, extending or restricting the scope of it, are frequently introduced into the contract. These provisions may be either express or implied. The expressed provisions,

⁵⁵See, Halsbury's Laws, at para. 371 ; Ivamy, at p. 148 ; R. Colinvau, at pp. 99 and 108 ; M. Clarke, at p. 567

⁵⁶Lynch and Jones v. Hamilton (1810) 3 Taunt 37 ; Watson v. Mainwaring (1813) 4 Taunt 763 ; Associated Oil Carriers Ltd v. Union Insurance Society of Canton Ltd [1917] 2 K.B. 184

⁵⁷De Costa v. Scandret (1723) 2 P. Wms 170 ; Lynch v. Dunsford (1811) 14 East. 494

⁵⁸W. Vance, at p. 376

⁵⁹See Seaman v. Fonereau (1743) 2 Stra. 1183 ; Lynch and Jones v. Hamilton (1810) 3 Taunt. 37 ; Lambert v. Co-operative Insurance [1975] 2 Lloyd's Rep. 485

in most cases, are linked with the basis of the contract into which the parties have actually entered. In other words, these stipulations are related to a warranty or a condition precedent. Therefore, the issue of materiality in this case has no room to be controversial.⁶⁰

However, the practice that the insurer alleging non-disclosure of a material fact has asked the insured some questions on that particular topic (where the answers to the questions do not create the basis of the contract) may help the courts determine materiality of non-disclosure, because there is a presumption of materiality as to the questions put to the insured by the insurer. Therefore, the court is more likely to decide in favor of the insurer who is alleging non-disclosure of a material fact, if he has asked the insured some questions about that particular point and if he has proved that other insurers in that type of insurance usually ask the same or similar questions. The insurer, through this practice, indicates the matters about which he wants information and which should be disclosed. The importance of this practice was discussed in Glicksman v. Lancashire and General Assurance Co.⁶¹ by Scrutton L.J. ;

"There is also no doubt that both in life and burglary insurance the insurance offices make it plain to the assured that they think it material to know whether anybody else has refused the risk. The question nearly always appears in some form or other in the proposal forms of these offices. And in my view, when it is shown to the assured that the underwriter is treating a certain fact as material, he comes under an obligation to disclose any fact of that character."⁶²

On the other hand, in England, there is no presumption of immateriality as to information which is not clearly requested by insurer. In other words, the practice of asking the insured to answer specific questions does not affect the duty to disclose

⁶⁰Halsbury's Laws, at paras. 366 and 379-380

⁶¹[1925] 2 K.B. 593

⁶²Ibid., at p. 609 ; Also see, Anderson v. Fitzgerald (1853) 4 H.L.C. 484 ; London Assurance v. Mansel (1879) 11 Ch.D. 363 ; Kumar v. Life Insurance Corpn. of India [1974] 1 Lloyd's Rep. 147

material facts which are not included in the questions made by insurer⁶³, unless the presumption of immateriality of information not covered by the questions is specially agreed between the parties. However, it has been modified by the introduction of the Statements of Insurance Practices. The Statement of General Insurance Practice clearly says that "Those matters which insurers have found generally to be material will be the subject of clear questions in proposal forms."⁶⁴ In the U.S.A., the importance of the questions put to the insured by the insurer is more apparent and it was held that there was presumption of immateriality as to the information not asked for, although there are some exceptions.⁶⁵

This practice, however, is not a necessarily decisive factor in determining materiality. Materiality is not automatically established through the insurer's asking a question about that particular point. It is the courts who have to decide materiality of undisclosed fact. The asking of a question is only one of all the circumstances of the case which the courts should consider in order to determine materiality, using common sense and their experiences. If the courts think, considering all the circumstances of the case, that the answers to the question, i.e., disclosure of the facts, would not have influenced the mind of a prudent insurer, non-disclosure of it will be held immaterial. Therefore, the courts have to consider both the practice of asking a question put to the insured by the insurer and all the relevant circumstances of the case in order to determine materiality.

5.2.3.5. PROOF OF MATERIALITY (EXPERT EVIDENCE)

5.2.3.5.1. GENERAL CONSIDERATION

⁶³Wainwright v. Bland (1836) 1 M. & W. 32 ; Dawsons v. Bonnin [1922] 2 A.C. 413 ; Glicksman v. Lancashire and General Assurance Co. [1925] 2 K.B. 593 ; Taylor v. Eagle Star Insurance (1940) 67 Ll.L.R. 136 ; Schoolman v. Hall [1951] 1 Lloyd's Rep. 139 ; Lee v. British Law Insurance Co. Ltd [1972] 2 Lloyd's Rep. 49

⁶⁴Para. 1(d) ; Also see, Para. 1(c) of the Statement of Long-Term Insurance Practice.

⁶⁵See, Stipcich v. Metropolitan Life Ins. Co., 277 U.S. 311 (1928), at p. 316 ; Hare & Chase v. National Surety 60 F 2d 909, at pp. 911-912 (2 Cir, 1932)

The question of whether a particular fact is material or not is one of the facts to be decided by the courts or, if necessary, by jury as representing reasonable men on the facts of the particular case.⁶⁶ The decision relies upon the judge's own appraisal of the particular circumstances as proved in evidence in each case. Therefore, this question of deciding materiality cannot be resolved by any automatic rule which can be generally applied to all sorts of cases.

It is clear that the burden of proof of materiality of non-disclosure rests on the insurer. The insurer who seeks to discharge his burden of proving materiality desperately needs the evidence of other insurers in that type of insurance. The evidence from other independent experts who represent the prudent insurer as to the opinion on the question is now admissible to prove materiality of a non-disclosure, and is needed to help the judge, who cannot pretend to be a prudent insurer, discover the standards and practice of the notional prudent insurer. Of course, if the materiality of an undisclosed fact is so obvious to the courts, any expert evidence is not needed to prove the materiality of that fact. In addition, if the materiality of an undisclosed fact is so palpable, then the presumption of inducement will be available in relation to the proof of actual insurer's inducement which becomes a separate requirement in order to avoid the policy. In Glicksman v. Lancashire and General Assurance Co.⁶⁷, Scrutton L.J. said ;

"If a shipowner desiring to insure his ship for the month of January knew that in that month she was heavily damaged in a storm, it would ... be ridiculous to call evidence of the materiality of that fact; the fact speaks for itself."⁶⁸

⁶⁶Hoare v. Bremridge (1872) 8 Ch. App. 22, at p. 28 ; Seaton v. Heath [1899] 1 Q.B. 782, at p. 791 ; Yorkshire Insurance Co. Ltd v. Campbell [1917] A.C. 218, at p. 221 ; The modern practice in insurance cases is to dispense with the trial by jury except in a case of fraud. See, Ivamy, at p. 148

⁶⁷[1925] 2 K.B. 593

⁶⁸Ibid., at p. 609 ; Also see Marene Knitting Mills Pty. Ltd. v. Greater Pacific General Insurance Ltd. [1976] 2 Lloyd's Rep. 631, at p. 642

When any expert evidence is not called, the judge may determine the materiality of that fact, using his own knowledge or experience, but such knowledge or experience of the judge may not necessarily be the same as that of the ordinary man.⁶⁹

5.2.3.5.2. HISTORY OF ADMISSIBILITY OF EXPERT EVIDENCE

The view of the courts as to the acceptance of the expert evidence as an aid to the establishment of materiality in insurance cases seems to have changed. About 200 years ago, the prevailing view was unfavorable to the acceptance of such evidence. Lord Mansfield said in *Carter v. Boehm*⁷⁰ ;

"It [the opinion of the broker] is mere opinion which is not evidence. ... It is opinion without the least foundation from any previous precedent or usage. ... therefore it is improper and irrelevant in the mouth of a witness."⁷¹

During those time, it was frequently held that the question of materiality of a fact undisclosed could not be proved by expert evidence. However, the importance of the function of this expert evidence had been appreciated later by the courts, and it has been an established practice in the courts to allow a proof of materiality of a fact undisclosed from the expert evidence. McCardie in *Yorke v. Yorkshire Insurance Co.*⁷² said ;

"Expert evidence with respect to the materiality of a fact has been freely admitted in recent years by the experienced judges who have administered, and are now administering, justice in the Commercial Court. ... Expert evidence may frequently afford great assistance to the Court upon questions of novelty or doubt."

⁶⁹*Glasgow Assurance Corp. Ltd v. Symondson* (1911) 16 Com. Cas. 109, at p. 119 ; Also see, Ivamy, at p. 169

⁷⁰(1776) 3 Burr. 1905, at p. 1918

⁷¹The similar views are found in *Traill v. Baring* (1864) 4 De G.J. & Sm. 318 and in *Fracis, Times & Co. v. Sea Insurance Co.* (1898) 79 L.T. 28

⁷²[1918] 1 K.B. 662, at p. 670

Now, the practice of calling expert evidence in order to determine materiality has been widely accepted.⁷³ However, it must be remembered that the practice of calling expert evidence is not always positively required in all cases.

5.2.3.5.3. FACTORS OF EXPERT EVIDENCE

[GENERAL PRACTICE AND OPINION]

Expert evidence should be the general practice and the opinion of persons engaged in the relevant kind of insurance business, i.e., persons who are conversant with the class of business to which the transaction in question belongs, as to whether the disclosure of the non-disclosed fact or circumstance is generally regarded as one which would influence the mind of a prudent insurer in fixing the premium or determining whether he will take the risk. Expert evidence should not be the particular opinion of the particular insurer in question. Consequently, the practice of calling expert evidence should be limited to the classes of case where a generally accepted practice has already been established and the general practice and opinion of a colleague in the same type of business are available.⁷⁴

[EXPERT EVIDENCE IN LIFE INSURANCE]

Although expert evidence, in most cases, is produced from witnesses engaged in the insurance industry such as directors or managers, the classification of expert evidence is not closed. In life insurance cases, the opinion of a medical practitioner who has wide

⁷³*Campbell v. Rickards* (1833) 5 B. & Ad. 840 ; *Ionides v. Pender* (1874) L.R. 9 Q.B. 531 ; *Thames and Mersey Marine Insurance Co. v. Gunford Ship Co.* [1911] A.C. 529 ; *Glasgow Assurance v. Symondson* (1911) 16 Com. Cas. 109 ; *Associated Oil Carriers Ltd v. Union Insurance Society of Canton Ltd* [1917] 2 K.B. 184 ; *Becker v. Marshall* (1922) 11 Ll.L.R. 114 ; *Regina Fur Co. Ltd v. Bossom*, [1957] 2 Lloyd's Rep. 466

⁷⁴*Traill v. Baring* (1864) 4 De. G.J. & Sm. 318, at p. 330 ; *Glasgow Assurance Corp. v. Symondson* (1911) 104 L.T. 254, at p. 257 ; *Horne v. Poland* [1922] 2 K.B. 364, at p. 365 (cf. *Hemwood v. Prudential Ass. Co.* (1967) 64 D.L.R. (2d) 715, at p. 731)

experience in advising life insurance companies as to the relevance of undisclosed facts about medical matters may be much more helpful for the court in reaching its conclusion of materiality. As far as medical matters are concerned, the insurer, even though he is a prudent insurer, must be a layman. Therefore, the testimony or opinion of the medical practitioner should be admitted as expert evidence for determining materiality.⁷⁵

5.2.3.5.4. NATURE OF EXPERT EVIDENCE

The function of expert evidence should be limited to assisting the court in determining materiality, not in deciding matter. In other words, expert evidence is only one of the relevant factors which the court should take into account in order to reach its conclusion, although in many cases it becomes the main body of evidence to be considered by the court. Expert evidence is in no way binding on the court. In other words, the purpose of expert evidence is to furnish the judge with the necessary scientific criteria for testing the accuracy of their conclusions so as to enable a judge to form his/her own independent judgment.⁷⁶ Consequently, it is the court who decides the question of materiality, considering all the relevant factors such as its own independent opinion, common sense, experience, whether the insurer asked the insured some relevant questions and the expert evidence.

5.2.3.6. CRITICISM OF A PRUDENT INSURER TEST

It would appear that the position of the insurer, which has been generally protected by the doctrine of the duty of disclosure, is now much more secured by acceptance of a prudent insurer test as a standard for determining materiality. It is apparent that the test

⁷⁵Lindenau v. Desborough (1828) 8 B.& C. 586, at pp. 591-593 ; Yorke v. Yorkshire Insurance Co. [1918] 1 K.B. 662, at pp. 670-671 ; Godfrey v. Britannic Assurance Co. Ltd [1963] 2 Lloyd's Rep. 515, at p. 531 ; Ivamy, at pp. 168-169 ; Bower, at p. 48 ; MacGillivray & Parkington, at para. 667

⁷⁶Reynolds v. Phoenix Assurance Co. Ltd [1978] 2 Lloyd's Rep. 440, at pp. 457-458

of prudent insurer imposes too heavy a burden on the insured. According to this test, the insured, even though he acts as a reasonable man with reasonable care and skill and discloses those facts which a reasonable insured would regard as material, may fail in his duty of disclosure. Furthermore, it may not be sufficient for the insured to disclose every fact that the particular insurer would wish to know about before accepting the risk. The requirement of the prudent insurer test goes further and more difficulties are clearly imposed on the insured.

The insured has to disclose all matters which would have been taken into account by the prudent insurer when he assesses the risk in question.⁷⁷ This is a really difficult task for the insured, because it is, in many cases, almost impossible for the insured to discover what facts will be regarded as material by a prudent insurer. According to the test of a prudent insurer, clairvoyant powers to discover what a reasonable insurer would regard as material are required to the insured. Therefore, even an innocent insured who has acted with reasonable care, but has not been aware of the materiality of a fact undisclosed may fail in his duty of disclosure, simply because a hypothetical prudent insurer may regard that fact as material.⁷⁸ If the insurer regards particular things as material, he should ask express questions about them. If these are not asked on the proposal form, the presumption of immateriality as to these facts should be accepted.

There was criticism of the lack of a good and reasonable justification as to why an insurer, who is not acting as a prudent insurer when the contract is made, should be entitled to avoid the policy for non-disclosure of a material fact in cases where the actual insurer in question would not in fact have been influenced by that fact and only the

⁷⁷The Pan Atlantic case [1994] 3 W.L.R. 677 ; The St. Paul case (1995) 45 Construction Law Reports 89

⁷⁸Becker v. Marshall [1922] 12 Ll.L.R. 413 ; Locker and Woolf v. Western Australian Insurance [1936] 1 K.B. 408 ; Schoolman v. Hall [1951] 1 Lloyd's Rep. 139 ; Lambert v. Co-operative Insurance Society Ltd. [1975] 2 Lloyd's Rep. 485 ; A. Diamond, *Ibid.*, at pp. 30-31 ; R. Merkin, *Ibid.*, at pp. 479-480 ; Merkin & McGee, at A.5.3-01-05

notional prudent insurer would have been influenced.⁷⁹ However, as far as this criticism is concerned, it seems to have been modified as a result of the recent decisions of the House of Lords in the Pan Atlantic case and of the Court of Appeal in the St. Paul case which accepted the requirement of the insurer's inducement in the making of the contract to avoid his liability, although the question of the presumption of inducement remains in relation to this new additional requirement.

The insurer can be more protected by the practice of accepting expert evidence. The insurer undoubtedly has an unfair advantage in relation to the practice of expert evidence. It would appear that the insurer, through his years of experience in the insurance industry, is much more accustomed to expert evidence which mostly comes from his fellow insurers. Such expert evidence will, in most cases, be readily available to the insurers. On the other hand, the insured may have a very limited opportunity to get access to expert evidence. Therefore, there is no equality between the parties in terms of access to expert evidence. In addition, it will be very difficult for the insured to rebut the expert evidence, most of which comes from the enormous insurance industry. Furthermore, although it is clearly accepted that the function of expert evidence is only to assist the courts and is not binding on the courts, the courts have very often accepted expert evidence as a decisive factor.⁸⁰ There is a doubtful opinion as to the credibility of expert evidence. Lush J. said in *Horne v. Poland*⁸¹ ;

"The evidence of the underwriters on that question amounted to this : that underwriters would not accept the risk of an alien for insurance as satisfactory. One or two of the witnesses said that they did not and would not insure aliens. I am doubtful whether evidence of that individual witnesses would do was admissible, ..." ⁸²

⁷⁹A. Diamond, *Ibid.*, at p. 31. He defines this situation as a fraud.

⁸⁰For example, see, *Becker v. Marshall* [1922] 12 Ll.L.R. 413 ; *Locker and Woolf v. Western Australian Insurance* [1936] 1 K.B. 408 ; *Schoolman v. Hall* [1951] 1 Lloyd's Rep. 139 ; *Lambert v. Co-operative Insurance Society Ltd* [1975] 2 Lloyd's Rep. 485

⁸¹[1922] 2 K.B. 364

⁸²*Ibid.*, at p. 365

Some recent cases such as Roselodge v. Castle⁸³, Spence J.'s dissenting opinion against the majority opinion in Hemwood v. Prudential Insurance Co.⁸⁴, Reynolds v. Phoenix Assurance Co.⁸⁵, Irish National Insurance Co. Ltd. v. Oman Insurance Co.⁸⁶ and Inversiones Manria S.A. v. Sphere Drake Insurance Co. plc, The Dora⁸⁷ clearly confirmed the view that expert evidence is not decisive, and the judge's commercial sense should be a decisive criterion in determining materiality. Likewise, a prudent insurer test along with the doctrine of the duty of disclosure gives unfair advantage to the insurer. The insured may suffer injustice by having his claim unduly rejected and his policy repudiated as a result of the present law and the interpretation of it. The repudiation and rejection may create real difficulties for him in obtaining fresh cover from other insurers, because the cancellation of cover, or the fact that an insurer has declined a proposal, may in themselves be material facts which should be disclosed to other insurers thereafter. MacKenna J., who delivered the main judgment in Lambert v. Co-operative Insurance Society Ltd⁸⁸, expressed his regret at the decision in relation to the test of a prudent insurer, saying that ;

"I would only add to this long judgment the expression of my personal regret that the Committee's recommendation has not been implemented. The present case shows that unsatisfactory state of the law. Mrs. Lambert is unlikely to have thought that it was necessary to disclose the distressing fact of her husband's recent conviction when she was renewing the policy on her little store of jewelry. She is not an underwriter and has presumably no experience in these matters. The defendant company would act decently if, having established the point of principle, they were to pay her. It might be thought a heartless thing if they did not, but that is their business, not, mine. I would dismiss the appeal."⁸⁹

⁸³[1966] 2 Lloyd's Rep. 113

⁸⁴(1967) 64 D.L.R. (2d) 715.

⁸⁵[1978] 2 Lloyd's Rep. 440

⁸⁶[1983] 2 Lloyd's Rep. 453

⁸⁷[1989] 1 Lloyd's Rep. 69

⁸⁸[1975] 2 Lloyd's Rep. 485

⁸⁹Ibid., at p 491 ; See, Ibid., at p. 492 (Lawton L.J.) and at p. 493 (Cairns L.J.) ; Also see, Highlands Insurance Co. v. Continental Insurance Co. [1987] 1 Lloyd's Rep. 109, at p. 114

Some suggestions for reform such as the recommendations of the Law Reform Committee⁹⁰, The Law Commission Report on Insurance Law⁹¹ and the Statements of Insurance Practice have been made in order to reduce the gap between the insurer and the insured in terms of equality. These suggestions are related to the discussion of other types of test for materiality, in particular a reasonable insured test.

5.2.4. A REASONABLE INSURED TEST

5.2.4.1. GENERAL CONSIDERATION

As a standard for the purpose of determining materiality, a "reasonable insured test" - what would a reasonable insured consider material? - has been accepted in some cases. According to this test, the question should be whether a reasonable man in the position of the insured, and with the knowledge of the allegedly material facts, ought to have realized that they were material to the risk. The main purpose of this view is to ease the task of the insured, since the operation of the present rule (a prudent insurer test) has revealed a considerable amount of injustice and has been greatly loaded in favor of the insurer. Although some indication of the "reasonable insured test" might be found in dicta in some earlier cases⁹², this test was discussed in full-scale by Fletcher Moulton L.J. in Joel v. Law Union and Crown Insurance Company.⁹³ ;

"That duty, no doubt, must be performed, but it does not suffice that the applicant should bona fide have performed it to the best of his understanding. There is the further duty that he should do it to the extent that a reasonable man would have done it;... The disclosure must be of all you ought to have realized to be material, not of that only which you did in fact realize to be so.... If a reasonable man would have recognized that it was material to disclose the knowledge in question, it is no excuse that you did not recognize it to be so."

⁹⁰5th Report (Conditions and Exceptions in Insurance Policies) Cmnd. 62 (1957)

⁹¹(Law Com. No. 104 ; Non-disclosure and Breach of Warranty), Cmnd. 8064 (1980)

⁹²Durrell v. Bederley (1816) Holt N.P. 283 ; Swete v. Fairlie (1833) 6 C. & P. 1 ; Fowkes v. London and Manchester Life Assurance Co. (1862) 3 F. & F. 440

⁹³[1908] 2 K.B. 863, at p. 884

Fletcher Moulton's "reasonable insured test" had been followed in a series of cases. For example, Lush J. said in *Horne v. Poland*⁹⁴ ;

"If a reasonable person would know that underwriters would naturally be influenced, in deciding whether to accept the risk and what premiums to charge, by those circumstances, the fact that they were kept in ignorance of them and indeed were misled, is fatal to the plaintiff's claim. The plaintiff was making a contract of insurance, and if he failed to disclose what a reasonable man would disclose he must suffer the same consequences as any other person who makes a similar contract."⁹⁵

Also in the 2nd (Hailsham) edition of the Laws of England, the "reasonable insured test" was adopted⁹⁶, and this view was repeated in the 3rd (Simonds) edition.⁹⁷

5.2.4.2. RATIONALE OF A REASONABLE INSURED TEST

A "reasonable insured test" seems to offer a more effective way to solve the question of proof. A reasonable insured test is merely a *reasonable man test* which the judges have, through practice, become fairly proficient in applying.⁹⁸ Therefore, it is submitted that if a "reasonable insured test" is adopted, the special expert evidence of other insurers which is badly needed in the case of a "prudent insurer test", and which has met with a lot of criticism as to both the unfair advantage which the insurer in question may have and the difficulties which the insured may have from this practice, will not be so crucial.

Another important role of the "reasonable insured test" is to make it possible to reduce the scope of the duty of disclosure. Over the past years, there have been a lot of cases

⁹⁴[1922] 2 K.B. 364, at p. 367

⁹⁵Also see, *Regina Fur Co. Ltd v. Bossom*, [1957] 2 Lloyd's Rep. 466, at p. 483 ; *Godfrey v. Britannic Assurance Company, Ltd* [1963] 2 Lloyd's Rep. 515, at p. 529 ; *Kelsall v. Allstate Insurance Co. Ltd*, The Times, March 20, 1987

⁹⁶In Sect. 586 (3), Vol. 18

⁹⁷In Sect. 360, Vol. 22 ; Also see, A. Welford, *The Law Relating to Accident Insurance*, (2nd ed., 1932), London, at p. 32

⁹⁸R. Merkin, "Uberrimae Fidei Strikes Again", (1976) 39 M.L.R. 478, at p. 480

in which many of the matters that have been held to be material by the prudent insurer test would be regarded as immaterial information if a reasonable insured test is adopted.⁹⁹ It is a heavy burden on the insured to discover what a prudent insurer would regard as material. Most insured, whether consumers or businessmen, do not have the knowledge or experience required to identify such facts. This almost impossible burden on the insured will be reimposed in case of the renewal of the policy, which, in most type of insurance, will be every year.

The scope of the insured's duty of disclosure, however, can be greatly reduced by a "reasonable insured test". Under this test, it seems to be sufficient for an insured to undertake his duty with reasonable care and skill, and no extra skill to predict what a prudent insurer would think as material is imposed upon the insured. The function of the "reasonable insured test" can be found even under the current "prudent insurer test". In cases where the insurer asks the insured some questions in a proposal form, these questions are construed not according to the prudent insurer who framed them, but according to how these questions would be read by the reasonable insured¹⁰⁰. Therefore, the role of the reasonable insured is important in responding to the questions in a proposal form even under the present "prudent insured test". Also, this test has the merit of emphasizing that the issue as to disclosability is one which has to be determined by the view of the jury, who represent reasonable men.¹⁰¹

5.2.4.3. CURRENT POSITION OF REASONABLE INSURED TEST

⁹⁹For example, *Becker v. Marshall* [1922] 12 Ll.L.R. 413 ; *Locker and Woolf v. Western Australian Insurance* [1936] 1 K.B. 408 ; *Schoolman v. Hall* [1951] 1 Lloyd's Rep. 139 ; *Lambert v. Co-operative Insurance Society Ltd* [1975] 2 Lloyd's Rep. 485 ; *Woolcott v. Sun Alliance and London Insurance* [1978] 1 W.L.R. 493

¹⁰⁰*Revell v. London General Ins. Co. Ltd* (1934) 50 Ll.L.R. 114, at pp. 116-117 ; Also see, *Hair v. Prudential Assurance Co. Ltd* [1983] 2 Lloyd's Rep. 667 ; M. Clarke, at pp. 538-539 and 563

¹⁰¹*Roselodge, Ltd v. Castle* [1966] 2 Lloyd's Rep. 113, at p. 131

This "reasonable insured test" was recommended by the Law Reform Committee in its Fifth Report, Conditions and Exceptions in Insurance Policies 1957 (Cmnd. 62). The Committee concluded that "for the purpose of any contract of insurance no fact should be deemed material unless it would have been considered material by a reasonable insured."¹⁰² The Committee added that any or all of the provisions which the Committee recommended could be introduced into the law and that no legal difficulties would arise in their application. Although the recommendation by the Law Reform Committee did not change the relevant provisions of the M.I.A. 1906, the recommendation seems to have, directly or indirectly, influenced the attitude of the courts. Firstly, the combination of the reasonable insured test and the prudent insurer test for the test of materiality was tried by Megaw J. in *Anglo African Merchants v. Bayley*¹⁰³. In this case, he said ;

"If, however, the assured knew of facts, and if as a reasonable man he should have realized that knowledge of those facts might be ... regarded as material by a normal prudent underwriter, then, if those facts are not disclosed and if they would have been material, the defense of non-disclosure prevails."

In *Lambert v. Co-operative Insurance Society Ltd.*¹⁰⁴ all three judges expressed their regret about the result, although they accepted the "prudent insurer test" as a standard for the purpose of determining materiality.¹⁰⁵ In 1980, the Law Commission considered that the present law of non-disclosure was unjust so that reform was needed. The Law Commission clearly objected to the view of abolition of any duty of disclosure. Instead, it recommended that the standard of disclosure should be modified, proposing that ;

¹⁰²Para. 14(1) of the Fifth Report of Law Reform Committee

¹⁰³[1969] 1 Lloyd's Rep. 268, at p. 277

¹⁰⁴[1975] 2 Lloyd's Rep. 485

¹⁰⁵*Ibid.*, at p. 491 ; For Lawton L.J.'s view, see at p. 492 and for Cairns L.J.'s view, see at p. 493

"The duty of disclosure... shall be limited to those material facts...(b) which a reasonable man in the position of the proposer would disclose to the insurer, having regard to the nature and extent of the insurance cover which is sought and the circumstances in which it is sought."¹⁰⁶

After the recommendations of the Law Reform Committee and The Law Commission, a small but positive step for reform is found in the Statement of General Insurance Practice 1986 and the Statement of Long-Term Insurance Practice 1986. These voluntary statements considered the test of the reasonable insured for the test of materiality, providing that an insurer is not allowed to repudiate his liability on grounds of non-disclosure of material fact, which the insured could not reasonably be expected to disclose.¹⁰⁷ Also, in *Kelsall v. Allstate Insurance Co. Ltd.*¹⁰⁸, in which the "prudent insurer test" was accepted, Parker L.J. tried to modify this test, adding that a warranty in a contract "no known adverse facts" required the policyholder to disclose only facts known by him, as a reasonable man, to be adverse. In Scotland, this "reasonable insured" test, which was established by Lord President Inglis in *Life Association of Scotland v. Foster*¹⁰⁹, has been regarded as a predominant test for materiality up to now. In Australia, some cases in relation to types of insurance other than marine insurance held that materiality was based on whether a reasonable insured would have realized that the information in question would affect the insurer's decision. In *Guardian Assurance v. Condogianis*¹¹⁰, Issacs J. adopted the reasonable insured test, stating that ;

¹⁰⁶See, The Law Commission Report on Insurance Law - Non Disclosure and Breach of warranty (Law. Com. No. 104) Cmnd. 8064 (1980), cl. 2(1) of the Draft Bill ; The Commission's proposals do not relate to marine, aviation and transport contracts nor to contracts of reinsurance.

¹⁰⁷Clause 2(b) of the Statement of General Insurance Practice 1986, and Clause 3(a) of the Statement of Long-Term Insurance Practice 1986

¹⁰⁸The Times, March 20, 1987

¹⁰⁹(1873) 11 M. 351

¹¹⁰(1919) 26 C.L.R. 231

"... to disclose such material facts as a reasonable man in his position would have considered material. If the hypothetical reasonable man in his position would have considered the previous fire five years before material, in the sense of influencing the Guardian Assurance Company in accepting or rejecting the risk or in fixing its premium, then Condogianis must be assumed to so consider and so had the duty of disclosing the fact."¹¹¹

Again, in Southern Cross Assurance Co. Ltd v. Australian Provincial Assurance Association Ltd¹¹², Jordan C.J. and Nicholas J. supported the reasonable insured test, saying that ;

"Since the contract of assurance is *uberrimae fidei* the assured is subject to an obligation ... to disclose to the Assurance Company every material fact known to him which a reasonable man would realize to be material."¹¹³

In Australia, the test of the 'prudent insurer', which had been the majority of the authorities, has been abolished as a result of the new Insurance Contracts Act 1984 (Commonwealth). Instead of it, s. 21 adopts a reasonable insured test as well as a particular insured test, by stating ;

"(1) Subject to this Act, an insured has a duty to disclose to the insurer, before the relevant contract of insurance is entered into, every matter that is known to the insured, being a matter that -(a) the insured knows to be a matter relevant to the decision of the insurer whether to accept the risk and, if so, on what terms ; or (b) a reasonable person in the circumstances could be expected to know to be a matter so relevant...."

It has been nearly 40 years since the Law Reform Committee recommended that a "reasonable insured test" should be adopted, and nearly 15 years since the Law Commission recommended the same test. No significant reform has been achieved so far, and they still remain as the proposal intended to be adopted for all form of consumer insurance. However, it is true that the acknowledgment of the need for reform has been widespread and some movements or indications for reform can be found in recent cases.

¹¹¹Ibid., at pp. 246-247 ; Issacs J. changed this view in Western Australian Insurance Co. Ltd v. Dayton (1924) 35 C.L.R. 355, at pp. 379-380, adopting the prudent insurer test.

¹¹²(1939) 39 S.R. (N.S.W.) 174

¹¹³Ibid., at p. 187

The reform of the duty of disclosure in insurance, in particular as to the test for materiality in non-disclosure, should be achieved, and the sooner, the better.

5.3. DEGREE OF INFLUENCE IN S. 18(2) OF M.I.A. 1906

5.3.1. GENERAL CONSIDERATIONS

The next question in relation to the test of materiality in s. 18(2) of the M.I.A. 1906 is what degree of influence is required, i.e., what effect the disclosure of the circumstance in question would have on the prudent insurer. This question of the necessary degree to which a hypothetical prudent insurer would have been influenced in his judgment if he had been aware of the relevant facts is far from being clear. In other words, the expressions "... would influence the judgment of a prudent insurer in fixing the premium, or determining whether he will take the risk" do not give a clear answer to this question.

The degree of influence of undisclosed facts on the prudent insurer must be various. However, the decisions of the reported cases after Carter v. Boehm¹¹⁴ give some indications as to its nature. A narrow view (decisive influence test) as to the degree of influence is that a fact is only material if a prudent insurer would have been decisively influenced. This narrow view can be divided into two more details.¹¹⁵ The first one is that a fact is so material that, had the undisclosed facts been told, the prudent insurer would have refused to make the contract at all. This interpretation has been upheld in certain jurisdictions of the U.S.A.¹¹⁶ The second is that materiality of undisclosed facts

¹¹⁴(1776) 3 Burr. 1905

¹¹⁵M. Clarke, "Failure to Disclose and Failure to Legislate : is it Material?-II", [1988] J.B.L. 298, at pp. 298-300 ; "Insurance Contracts and Non-Disclosure - *Pan Atlantic v. Pine Top* -" [1993] L.M.C.L.Q. 297, at pp. 297-298

¹¹⁶Klingman v. National Indemnity Co. 317 F.2d. 850 (7 Cir., 1963) ; Fernandez v. Windsor Life Insurance Co. 372 N.Y.S. 2d. 357 (1975) ; Knight v. U.S. Fire Insurance Co. 651 F. Supp. 471 (S.D.N.Y. 1986) ; More recently, Evora v. Henry 559 A. 2d. 1038 (1989) ; American Home Assurance Co. v. Fremont Indemnity Co. 745 F. Supp. 974 (S.D.N.Y. 1990) ; However, this interpretation was rejected in Elston v. Phoenix Prudential Australia Ltd. [1987] 2 Qd. 354

is decided by the fact that if the prudent insurer had possessed the relevant facts, he would still have made the contract but with different terms, in particular with a different premium, from those which he accepted before. This explanation has been ruled in old English cases¹¹⁷, in most jurisdictions of the U.S.A.¹¹⁸ and in Australia.¹¹⁹

On the other hand, a broad view of the degree of influence of undisclosed facts on the prudent insurer (anti-decisive influence test) is that it is sufficient that the fact would have been relevant to the process of the evaluation of the risk by the prudent insurer, although the fact could be eliminated later by the prudent insurer as unimportant.¹²⁰ This broad view requires neither the prudent insurer's refusal of the contract nor his change of the terms including premium in order to establish materiality. Likewise, according to this broad view, the undisclosed facts do not have to make any difference to the contract or its terms including premium.

¹¹⁷Stribley v. Imperial Marine Insurance Co. (1876) 1 Q.B.D. 507, at p. 512 ; Blackburn, Low & Co. v. Vigors (1886) 17 Q.B.D. 553, at p. 562, Lord Esher M.R.'s dissenting judgment was upheld by the House of Lords (1887) 12 App. Cas. 531 ; Laing v. Union Marine (1895) 1 Com. Cas. 11, at pp. 17-18 ; London General Omnibus v. Holloway [1912] 2 K.B. 72, at p. 77 ; Cantiere Meccanico Brindisino v. Janson [1912] 3 K.B. 452, at p. 467

¹¹⁸Penn Mutual Life v. Mechanics' Savings Bank 72 F. 413, at p. 429 (6 Cir., 1896) ; Hare & Chase v. National Surety 49 F. 2d. 447, at p. 457 (S.D.N.Y., 1931) ; Clemmer's Administrator v. Jefferson Standard Life Insurance Co. 9 F. Supp. 115 (W.D. Va., 1934) ; New York Life v. Kuhlensadt 33 N.E. 2d. 340, at pp. 347-348 (S.C. Indiana, 1941) ; American Eagle Fire Insurance Co. v. Peoples Compress Co. 156 F. 2d 663 (10 Cir., 1946) ; Garvey v. Old Colonial Insurance Co. 153 F. Supp. 755 (E.D. N.C., 1957) ; Welded Tube Co. v. Hartford Fire Insurance Co. 1973 A.M.C. 555, at p. 563 (E.D. Pa., 1973) ; More recently, Parker v. Prudential Insurance Co. 900 F. 2d. 772 (4Cir., 1990) ; Petersen v. Mutual Life Ins. Co. 803 P. 2d. 406, at p. 409 (Alaska, 1990)

¹¹⁹Barclay Holdings (Australia) Pty. Ltd v. British National Insurance Co. Ltd (1987) N.S.W.L.R. 514, at p. 523 ; H. Yeo, "Common Law Materiality - an Australian Alternative" [1990] J.B.L. 97 ; A. Scoford, "Chipping away at C.T.I. v. Oceanus" [1988] L.M.C.L.Q. 30

¹²⁰Container Transport Int'l Ins. v. Oceanus Mutual Underwriting Association (Bermuda) Ltd [1984] 1 Lloyd's Rep. 476, at pp. 492, 511 and 529 ; Highlands Insurance Co. v. Continental Insurance Co. [1987] 1 Lloyd's Rep. 109, at pp. 113-114 ; Pan Atlantic Ins. Co. v. Pine Top Ins. Co. [1994] 3 W.L.R. 677, at pp. 682, 695, 705, 713 and 714 ; St. Paul Fire and Marine Insurance Co. Ltd v. McConnell Dowell Constructors Ltd (1995) 45 Construction Law Reports 89

The difference between the narrow view and the broad view on the degree of influence was well explained by Glass J.A. in an Australian case - Barclay Holdings (Australia) Pty. Ltd v. British National Insurance Co. Ltd¹²¹ ;

"The difference, it seems to me, between the two views, is whether the relevance of the hypothetical facts, assuming that they had been disclosed, is judged at the moment the underwriter is deciding whether or not to accept the risk, or at the moment when he undertakes an investigation of the risk."

The broad view was adopted in the Court of Appeal in the C.T.I. case. Although it was slightly modified by Steyn L.J. in the Court of Appeal in the Pan Atlantic case, the House of Lords in Pan Atlantic case and the Court of Appeal in St. Paul case confirmed that it was not necessary that the non-disclosure should have a decisive effect on the mind of the prudent insurer in his acceptance of the risk or on the amount of premium demanded. Likewise, this broad view is the currently accepted rule in England.

5.3.2. THE C.T.I. CASE

5.3.2.1. THE FACTS

C.T.I. (the first plaintiff) carried out a hire business in the hiring out of containers for use in ocean transport and was a subsidiary of the second plaintiffs. C.T.I. devised a "Damage Protection Plan" as a result of recurrent disagreement with lessees as to the responsibility for repairs for small items of damage. The first underwriters, the American firm of Crum and Forster, were not happy with the subsequent claims experience, and advised C.T.I. that they would only continue with the insurance on the changed terms including a highly increased premium which C.T.I. found unacceptable. C.T.I.'s agents then obtained cover with Lloyd's. However, the Lloyd's experience was no better than the first underwriters and the leading underwriters at Lloyd's eventually

¹²¹(1987) N.S.W.L.R. 514, at p. 523

gave notice of cancellations, whereas one underwriter gave an extension cover of 6 months.

C.T.I. then insured with the defendants, Oceanus, on the basis of an account of C.T.I.'s past claims record. The plaintiffs, C.T.I., demanded payments of their claims in the event. Oceanus declined to pay any further claims pending investigation and gave formal notice that they would not be renewing on any basis. Oceanus' solicitors wrote avoiding the policy on the ground of non-disclosure and misrepresentation, contending that (a) C.T.I. had failed to disclose their unsatisfactory claims record against previous underwriters; (b) that C.T.I. had failed to disclose a refusal by underwriters to renew.

5.3.2.2. AT FIRST INSTANCE

Lloyd J., trial judge, seemed to be influenced by the decision of Lord Salvesen Mutual Life Insurance Co. (New York) v. Ontario Metal Products Ltd.¹²² This case has been said to be an important authority for the discussion of the nature of materiality in the duty of disclosure. The reason is that in Ontario the introduction of "warranties" into the insured's answers to the questions put to him by the insurer is not allowed by the statutes. Therefore, a pure conception of materiality of undisclosed facts, under this circumstance - not having the force of warranties -, will play a great part in determining materiality. Lord Salvesen explained his view on the test of materiality ;

"...suggested that the test was whether, if the fact concealed had been disclosed, the insurers would have acted differently, either by declining the risk at the proposed premium or at least by delaying consideration of its acceptance... If the former proposition were established in the sense that a reasonable insurer would have so acted, materiality would, their Lordships think, be established, but not in the latter if the difference of action would have been delay and delay alone. ... it is a question of fact in each case whether, if the matters concealed or misrepresented had been truly disclosed, they would, on a fair consideration of the evidence, have influenced a reasonable insurer to decline the risk or to have stipulated for a higher premium."¹²³

¹²²[1925] A.C. 344

¹²³Ibid., at pp. 351-352

It would appear that the above Canadian case supported the view that some "difference of action" is required in order to establish materiality, and it seemed clearly to distinguish the word "would" from the word "might". Under the influence of this case, Lloyd J. focused on the meaning of the word 'would' and 'influence' in section 18 (2) of the M.I.A. 1906, saying that ;

"In general I would say that underwriters ought only to succeed on a defense of non-disclosure if they can satisfy the Court by evidence or otherwise that a prudent insurer, if he had known the fact in question, would have declined the risk altogether or charged a higher premium."¹²⁴

He went on expressing his own view as to the meaning of the word 'influence', saying that;

"It can never be enough for the prudent insurer to say 'Yes, I would have liked to know this or that fact, so that I could have made up my mind what to do about it ... some 'difference of action' is required in order to establish materiality. The mind of the reasonable insurer must have been influenced so as to induce him to refuse the risk or alter the premium... insurers must show that the result would have been affected. In the sense that the prudent insurer would in fact have declined the risk, or increased the premium."¹²⁵

Therefore, Lloyd J.'s ruling as to the test of materiality requires evidence showing that the prudent insurer, had a fact been disclosed, would have *in fact* declined the risk or charged a higher premium in order to avoid the contract with a defense of non-disclosure. Likewise, according to his interpretation, it is not enough for the fact to be of some relevance to the assessment of the risk.

5.3.2.3. COURT OF APPEAL

Lloyd J.'s decisive influence test for materiality was unanimously rejected by the Lord Justices of the Court of Appeal. (Kerr L.J., Parker L.J. and Stephenson L.J.) The kernel

¹²⁴[1982] 2 Lloyd's Rep. 178, at p. 187

¹²⁵Ibid., at pp. 188-189

of the Court of Appeal's interpretation of s. 18(2) of the M.I.A. 1906 is that this section does not necessarily require the insurer to show that a prudent insurer would have declined the risk or charged a higher premium. According to the Court of Appeal's decision, it is sufficient to show that a notional prudent insurer would have wished to know of the fact in making his decision. In other words, the crucial issue is relevance of the information to the prudent insurer's assessment of the risk, not whether disclosure of the information would have had a determinative impact upon the insurer's final decision. Therefore, the different decision of the prudent insurer is not the prerequisite condition for being a material fact, and what is necessary is that the fact in question, if disclosed, would have had some impact on the prudent insurer's underwriting decision.

Kerr L.J. in the Court of Appeal, who delivered the main judgment, expressed his own view of the meaning of the word "influence", reversing his earlier view of the subjective materiality test in *Berger and Light Diffusers Pty. Ltd. v. Pollock*¹²⁶, saying that ;

"The word "influence" means that the disclosure is one which would have had an impact on the formation of his opinion and on his decision-making process in relation to the matters covered by s. 18(2)... it may be relatively easy to say simply: "Had I known this, I would have declined the risk, or imposed such-and-such a term, or charged such-and such a premium". But this is not the nature of the evidence to which s. 18(2) is directed.... The section is directed to what would have been the impact of the disclosure on the judgment of the risk formed by a hypothetical prudent insurer..."¹²⁷

It would appear that the most important factor for determining materiality, according to Kerr L.J.'s reasoning, is the "relevance" of the information to the process of formation of opinion, not the "weight" of it. Therefore, if the prudent insurer said that the newly disclosed fact would have made him take it into account when making his decision, although he might have had the same underwriting judgment in fixing the premium or determining whether he will take the risk, it is sufficient to be a material fact. In other words, it suffices in order to establish materiality that the decision of a hypothetical

¹²⁶[1973] 2 Lloyd's Rep. 442

¹²⁷[1984] 1 Lloyd's Rep. 476, at p. 492

prudent insurer *might* have been influenced, not *would* have been influenced, had a fact been disclosed.¹²⁸ Consequently, this Court of Appeal's interpretation seems to substitute the word "might" for the word "would" in s. 18(2). Kerr L.J. referred to some old authorities in order to support his own broad interpretation on the degree of influence.¹²⁹ Among them, Turner L.J.'s decision in *Traill v. Baring*¹³⁰ seemed to be very similar to Kerr L.J.'s interpretation ;

"it is impossible to say what course the plaintiff might have pursued, whether they would or would not have accepted the policy. They might have done so, but it is equally clear that they might not, and we cannot say whether they would or would not; but it was to them that the communication should have been made, in order that they might exercise their opinion upon the subject."¹³¹

Another judge, Parker L.J., expressed his view that the relevance of the fact undisclosed in relation to the process of formation of opinion or the decision-making process rather than the final decision of the prudent insurer should be the criterion for the interpretation of s. 18(2) of the M.I.A. 1906, relying on Samuels J.'s judgment in *Mayne Nickless Ltd. v. Pegler and Another*¹³² ;

"...I do not think that it is generally open to examine what the insurer would in fact have done had he had the information not disclosed. The question is whether that information would have been relevant to the exercise of the insurer's option to accept or reject the insurance proposed."¹³³

¹²⁸It has been said that the distinction between 'would' and 'might' has been blurred according to the decision of the Court of Appeal in C.T.I. case. It seems that the Court of Appeal in this case preferred 'might' to 'would' as a degree of influence of the undisclosed facts and circumstances. See, R. Colinvax, at p. 107 ; Also see, K. Khan, "A New Test for Materiality in Insurance Law", [1986] J.B.L. 37, at pp. 39-40

¹²⁹*Traill v. Baring* (1864) 4 De G. J. & S. 318 ; *Bates v. Hewitt* (1867) L.R. 2 Q.B. 595 ; *Rivaz v. Gerussi* (1880) 6 Q.B.D. 222 ; *Tate v. Hyslop* (1885) 15 Q.B.D. 368

¹³⁰(1864) 4 De G. J. & S. 318

¹³¹*Ibid.*, at p. 330

¹³²(1974) 1 N.S.W.L.R. 228

¹³³*Ibid.*, at p. 239 ; This decision was followed in *Marene Knitting Mills Ltd v. Greater Pacific General Insurance Ltd* [1976] 2 Lloyd's Rep. 631

It would appear that Parker L.J. linked the reason of his preference for the anti-decisive influence test with the choice of a prudent insurer test as a yardstick for determining materiality. According to his reasoning, a stringent interpretation such as "decisive influence test" would give rise to some difficulties in practice under the prudent insurer test. He pointed out the fact that whether the influence of a circumstance would or would not be great enough to cause a prudent insurer to refuse the risk or charge a higher premium must vary among the prudent insurers, and the court, perhaps years after the event, would have to ascertain what a prudent insurer would have done in all the circumstances.

In relation to this problem, he referred to a possible evidential problem. In other words, expert evidence presented by some underwriters in that type of insurance about what they would have done had a fact been disclosed might be different each other. Some may refuse to take the risk, others charge a higher premium while some prudent insurers may accept the risk without any changed terms including the premium. Parker L.J. emphasized that a broad interpretation of the degree of influence could resolve these problems. Instead of considering that the prudent insurers would have acted differently, what is required is that the nature of the undisclosed fact must have a "bearing" on the risk or a "tendency" towards declining the risk or charging a higher premium. As to this point, he said ;

"It was contended that, unless an undisclosed circumstance would have led a prudent insurer to decline the risk when he would otherwise have accepted it, ... the circumstance cannot be said to be one which would influence the judgment of a prudent insurer... The sub-section certainly does not in clear words so provide and had the result been intended it would have been easy to say so. The contrary intention is however in my view clear ... It is possible to say that prudent underwriters in general would consider a particular circumstance as bearing on the risk and exercising an influence on their judgment... It is not possible to say... that prudent underwriters in general would have *acted* differently, because there is no absolute standard by which they would have acted..."¹³⁴

¹³⁴[1984] 1 Lloyd's Rep. 476, at pp. 510-511 ; Stephenson L.J. agreed with the above explanation as to the test for materiality. see, Ibid., at pp. 527-529

It would appear that Stephenson L.J. linked his choice of the broad interpretation to the fact that the duty of disclosure is one aspect of an overriding duty of utmost good faith in s. 17 of the M.I.A. 1906, saying ;

"That duty seems to require full disclosure and full disclosure seems to require disclosure of everything material to the prudent underwriter's estimate of the character and degree of the risk; and how can that be limited to what can affirmatively be found to be a circumstance which would in fact alter a hypothetical insurer's decision?"¹³⁵

In other words, according to his reasoning, everything which would have an impact on the formation of the prudent insurer's opinion or his decision-making process should be disclosed, and therefore a broad test should be applied.¹³⁶ Likewise, according to the Court of Appeal, the insurer need not show (a) that the non-disclosure would probably have had a decisive influence in the sense that the prudent insurer would have declined the risk or would have written the risk on different terms in respect of the rate of premium or otherwise (b) that he was induced by the non-disclosure of a material fact to take the risk which he would not otherwise have underwritten or to charge a lower premium which he would not otherwise have charged. In this sense,, C.T.I.'s test of materiality can be described as quite a relaxed test.¹³⁷

5.3.3. PAN ATLANTIC CASE

5.3.3.1. THE FACTS

The plaintiffs were the reassured and the defendants were the reinsurers under a "Casualty Account Excess of Loss" contract. This contract, which was a renewal of

¹³⁵Ibid., at p. 527

¹³⁶Stephenson L.J. concluded that "everything is material to which a prudent insurer, if he were in the proposed insurer's place, would wish to direct his mind in the course of considering the proposed insurance with a view to deciding whether to take it up and on what terms, including premium." Ibid., at p. 529

¹³⁷The House of Lords granted leave to appeal. However the dispute was resolved by agreement shortly before the appeal began.

similar contracts on which the defendants were reinsurers covering losses in 1980-1981, covered losses occurring in 1982, and contained an "errors and omissions" Clauses, saying ;

"It is hereby declared and agreed that any inadvertent delays, omissions, or errors made in connection with this Re-insurance shall not be held to relieve either of the parties hereto from any liability which would have attached to them if such delay, omission or error had not been made, provided rectification be made upon discovery..."

The plaintiffs had been reinsured, elsewhere, for 1977-1979. During the negotiation for renewal in 1982, the broker had presented the 1977-1979 and 1980-1981 loss records to the defendants. The plaintiffs made claims under the contract and the defendants asserted that the broker had produced the 1977-1979 loss records in such a way that the defendants' attention was diverted away from the records which were so bad that a prudent insurer would not have accepted the risk in 1982 on the terms agreed. The defendants also alleged that two losses had not been recorded in the 1981 record which therefore showed losses at half the true rate. Accordingly, the defendants repudiated their liability on the grounds that there was (1) non-disclosure in respect of the 1977-1979 record and (2) non-disclosure and/or misrepresentation in respect of the additional losses in 1981-1982. The main question for decision was what was the appropriate test for materiality.

5.3.3.2. AT FIRST INSTANCE

Waller J. followed the anti-decisive influence test which was the decision of the Court of Appeal in C.T.I. case, by simply saying that ;

"It is accepted that I must take the law as laid down in C.T.I. v. Oceanus Mutual Underwriting Association (Bermuda) Ltd. [1984] 1 Lloyd's Rep. 476. That case made clear that in considering ss. 18, 19 and 20 of the Marine Insurance Act 1906, any circumstance is material,... if it is a circumstance which would have had an impact on the formation of his opinion and on his decision making process."¹³⁸

¹³⁸[1992] 1 Lloyd's Rep. 101, at p. 103

On the facts of this case, it is unquestionable that the defendants were imprudent in not having insisted on seeing the above figures. With this test of materiality, however, Waller J. held that defendant's avoidance was allowed on the basis that the misrepresented losses for 1981 amounted to a material non-disclosure.

5.3.3.3. COURT OF APPEAL

Steyn L.J., who delivered the main judgment, confirmed that the test of materiality was the one stated in the Court of Appeal in the C.T.I. case, i.e., the test of materiality was one which the prudent insurer would have wished to know either the undisclosed fact, or the truth of the misrepresented one. However, he thought that the test of materiality laid down in the C.T.I. case set up only a so-called negative proposition.¹³⁹ The C.T.I.'s test only decided that a fact might be material without having a decisive influence on the judgment of a hypothetical prudent insurer, whereas it did not explore a full analysis as to the so-called positive question, i.e., what degree of influence of non-disclosure on the judgment of the notional prudent insurer is required. In other words, all that the C.T.I.'s test represents is that the test for the impact of non-disclosure of a material fact is not the decisive influence test.¹⁴⁰

Unlike the C.T.I. case, the Court of Appeal in the Pan Atlantic case tried to formulate a test of materiality which also covers the degree of influence of non-disclosure on the mind of a prudent insurer. In general, having rejected the decisive influence test, there are two possible alternative interpretations. The first is that a fact is material if a prudent insurer would have wished to be aware of it in reaching his decision. (mere influence test). The second one is that a fact is material if it would cause a prudent insurer to appreciate that the risk is different and increased from that actually presented to him.

¹³⁹[1993] 1 Lloyd's Rep. 496, at pp. 503-504

¹⁴⁰Ibid., at p. 505 ; Also see, H. Bennett, "The Duty to Disclose in Insurance Law", (1993) 109 L.Q.R. 513, at p. 516 ; J. Birds, at p. 100 ; Merkin & McGee, at A.5.3-04-05

(increased risk test) It is submitted that this second interpretation considered the fact that avoidance for non-disclosure is a remedy provided by the law, because the risk presented is different and increased from the true risk.

Steyn L.J., who accepted the mere influence test in *Highlands Insurance Co. v. Continental Insurance Co.*¹⁴¹, chose the second interpretation as a correct test of materiality in the belief that the problems which C.T.I. had caused would be considerably ameliorated, and his proposed test of materiality would produce a more generous approach to the issue of utmost good faith. In other words, he put some restrictions on the existing anti-decisive influence test by introduction of the concept of tending to increase the risk, saying that ;

"... as the law now stood the question was whether the prudent insurer would view the undisclosed material as probably tending to increase the risk."¹⁴²

He ruled that the key point for determining materiality should be whether or not the prudent insurer would view the undisclosed material as probably tending to increase the risk. Therefore, according to this formulation, the minimum requirement of the proof that a prudent insurer would have regarded the fact as increasing the risk in question, is needed in order to establish materiality. Farquharson L.J. and Nicholls V.-C. also agreed with Steyn L.J.'s slightly restricted test for materiality.¹⁴³ It would appear that the test of materiality in the Court of Appeal in the Pan Atlantic case has slightly drawn back from the C.T.I.'s test of materiality by linking the undisclosed fact with the risk in question.

However, Steyn L.J. also made it clear that it was not necessary to prove that the insurer, possessing the fact in question, would have taken a different decision about the

¹⁴¹[1987] 1 Lloyd's Rep. 109, at pp. 113-114

¹⁴²[1993] 1 Lloyd's Rep. 496, at p. 506

¹⁴³*Ibid.*, at p. 508

acceptance of the risk. The prudent insurer might not have declined the risk nor charged a higher premium. In addition, the insurer still need not show that he was personally induced by the non-disclosure of a material fact to take the risk that he would not otherwise have underwritten or to charge a lower premium than he would otherwise have charged. According to Steyn L.J.'s test of materiality, it is enough for the particular insurer to show that a prudent insurer in his position would regard the undisclosed material as probably tending to increase the risk. Therefore, except for the introduction of the concept of "tending to increase the risk", it would appear that many aspects of the test presented by the Court of Appeal in the Pan Atlantic case is still similar to the broad view of the Court of Appeal in the C.T.I. case.

5.3.3.4. TEST OF HOUSE OF LORDS IN PAN ATLANTIC CASE

Although the test of materiality laid down in the Court of Appeal in the C.T.I. case has been criticized, both the trial judge and the Court of Appeal in the Pan Atlantic case were bound by it. The decision of the House of Lords in the Pan Atlantic case had been eagerly waited, because it was a very good opportunity to review the existing tests with regard to the question of materiality, considering the fact that these tests had proved to be remarkably unpopular not only in the legal profession but also in the insurance market. Interestingly enough, the plaintiffs' contention in this case seems to coincide with the consensus in the legal literature which has severely criticized the existing tests, whereas the defendants' argument is based on the C.T.I. test. In other words, the plaintiffs submitted that the insurer must show (1) that a prudent insurer, if he had known of the undisclosed fact, would either have declined the risk altogether or charged an increased premium, and (2) that the actual insurer had been personally induced to enter into the contract in order to avoid the policy. In contrast, the defendants argued (1) that it was sufficient that the fact was one which a prudent insurer would have wanted to know or would have taken into account, even though it would have made no difference to him in the result, and (2) that the impact on the actual insurer was

irrelevant. Consequently, the characteristic of this decision became a challenge to the C.T.I.'s test of materiality. The House of Lords held, on a bare majority,¹⁴⁴ that a material circumstance was one that would have an effect on the mind of the prudent insurer in weighing up the risk, and it was not necessary that it should have a decisive effect on his acceptance of the risk or on the amount of premium demanded.¹⁴⁵ According to the majority decision, it is merely necessary for the facts to be of some relevance to the decision-making process of the prudent insurer. As to this issue, Lord Mustill said ;

"... the duty of disclosure extended to all matters which would have been taken into account by the underwriter when assessing the risk (i.e. the speculation) which he was consenting to assume. This is in my opinion what the Act was intending to convey and what it actually says."¹⁴⁶

It would appear that the first reason for choosing this anti-decisive effect test in the House of Lords is related to the wording in s. 18(2) of the M.I.A. 1906 which does not expressly require that the circumstance in question should have a decisive influence on the judgment of the insurer. As to this point, Lord Mustill said ;

"The legislature might here have said '*decisively* influence' or '*conclusively* influence' or 'determine the decision' or all sorts of similar expressions, in which case Pan Atlantic's argument would be right. But the legislature has not done this, and has instead left the word 'influence' unadorned ... 'influence the judgment' is not the same as 'change the mind'. Furthermore, if the argument is pursued via a purely verbal analysis, it should be observed that the expression used is 'influence the judgment of the underwriter in... determining *whether* he will take the risk.' To my mind, this expression clearly denotes an effect on the thought processes of the insurer in weighting up the risk, quite different from the words which might have been used but were not, such as 'influence the insurer *to* take the risk'."¹⁴⁷

¹⁴⁴Lord Mustill, Lord Goff of Chieveley and Lord Slynn of Hadley delivered the majority view.

¹⁴⁵[1994] 3 W.L.R. 677, at pp. 682, 695-696, and 714-715. Therefore, the C.T.I.'s decision was not overruled in this context.

¹⁴⁶*Ibid.*, at p. 702 ; Lord Templeman and Lord Lloyd of Berwick dissented this conclusion. From Lord Lloyd's point of view, Pan Atlantic won the law, but lost on the facts in this case. In fact, Pan Atlantic lost in every court, no matter what test of materiality was applied.

¹⁴⁷*Ibid.*, at p. 695 ; Also see, at p. 682

Secondly, their Lordships thought that the decisive effect test might face insuperable practical difficulties. Considering the nature of the duty of disclosure, the question of materiality of a fact is considered by the insured before he enters into the contract. Under this circumstance, it seems to be unrealistic to expect him to be able to identify a particular fact which would have a decisive effect on the mind of the insurer, whereas it seems to be reasonable to expect that the insured, who is aware of his duty of disclosure, should be able to identify those circumstances which would have an impact on the mind of the insurer in weighing up the risk.

In addition, the House of Lords supported the anti-decisive influence test because they thought that the decisive influence test could operate only in the exceptional situation in which the underwriters who were called to give expert evidence were agreed that they would have rejected the contract or increased the premium level. The anti-decisive influence test argues that weighing expert evidence would be more difficult where experts are asked to say whether or not the disclosure of a particular fact would have had a decisive influence. Consensus is more likely if the anti-decisive influence test is adopted. In addition, the anti-decisive influence test maintains that this test would not operate unfairly on the insured, considering the fact that the new requirement of the insurer's actual inducement by the non-disclosure is now needed in order to avoid the contract. Lord Mustill thought that it was easier for the insured to disclose everything relevant to the decision-making process and this was a better way of avoiding the practical difficulties, saying that ;

"I am bound to say that in all but the most obvious cases the 'decisive influence' test faces them with an almost impossible task. How can they tell whether the proper disclosure would turn the scale? By contrast, if all that they have to consider is whether the materials are such that a prudent underwriter would take them into account, the test is perfectly workable."¹⁴⁸

¹⁴⁸Ibid., at p. 696

Thirdly, the advocates of the anti-decisive influence test believed that case law was not inconsistent with the anti-decisive influence test. It is because they believed that there was no clear authority to support the decisive influence test, considering the fact that this particular question of the degree of influence had not been addressed before in earnest, and that a party was not allowed to give evidence in his own case before the Evidence Act 1851. In fact, Lord Mustill relied more heavily on 19th century text-books than on case law, and did not find anything to suggest that the decisive influence test was the prevailing view before 1906. With these reasons, the House of Lords, on a bare majority, adopted the anti-decisive influence test.

Then, the next question is what Lord Mustill's formulation of the test of materiality with which Lord Goff and Lord Slynn agreed means. What test of materiality did the House of Lords adopt, rejecting the decisive influence test? Is this the lesser standard as to the test of materiality, which Lord Mustill put the question to himself? The rejection of the decisive influence test theoretically leaves two interpretations open, which was already discussed by Steyn L.J. in the Court of Appeal in this case. After analyzing the authorities and textbooks, Lord Mustill said that ;

"... they furnish substantial support for the view that the duty of disclosure extended to all matters which would have been taken into account by the underwriter when assessing the risk (i.e., the speculation) which he was consenting to assume. This is in my opinion what the Act was intending to convey, and what it actually says."¹⁴⁹

In relation to appreciation of the real meaning of the above test of materiality, the question is whether this test is consistent with Steyn L.J.'s test of materiality, - a fact is material if it would cause a prudent insurer to appreciate that the risk was different and increased from that actually presented to him -, which was upheld by the Court of Appeal in Pan Atlantic case. None of the Law Lords expressly approved or denied Steyn L.J.'s test of materiality. It would appear that the implication of Lord Mustill's phrase

¹⁴⁹Ibid.,at p. 702

"all matters which would have been taken into account by the underwriters when assessing the risk" is that the test of materiality should be related with the estimate of the risk. In this context, this concept seems to be consistent with Steyn L.J.'s test of materiality which restricted the scope of the test of materiality to the issue of the estimate of the risk in question. ("but for the non-disclosure, the prudent underwriter would have appreciated that it was a different... risk") However, Steyn L.J.'s test of materiality needs further requirement whether the prudent insurer would view the undisclosed material as probably tending to increase the risk. Based on the House of Lords' another important decision in the Pan Atlantic case that the inducement of the actual insurer should be required and proved, it would appear now that there is no particular reason why the test of materiality should be limited to factors which are tending to increase the risk, which was necessary when the role of the actual insurer was denied. Considering the fact that the main core of Steyn L.J.'s test is whether the prudent insurer would view the undisclosed material as probably tending to increase the risk, it would appear that Steyn L.J.'s formulation of the test of materiality has not survived the House of Lords' decision in the Pan Atlantic case. In this context, Lord Mustill's lesser standard of the test of materiality seems to be different from Steyn L.J.'s test of materiality.¹⁵⁰ In other words, Steyn L.J.'s formulation of the test of materiality has now been superseded by the majority view on the issue of materiality in the House of Lords in Pan Atlantic. ("all matters were material which would have been taken into account by the underwriter when assessing the risk")

5.3.4. ST. PAUL CASE

5.3.4.1. THE FACTS

¹⁵⁰Also see, N. Fancourt and A. Gouge, "The English law of non-disclosure revised - The House of Lords decision in Pan Atlantic v. Pine Top", [1994] 10 Int'l I.L.R. 392 ; P. Stanley "Avoidance for misrepresentation or non-disclosure: Pan Atlantic v. Pine Top in the House of Lords", [1994] International Journal of Insurance Law 245, at p. 247.

A construction works insurance (Contractors All Risks) was made by the plaintiffs for the defendants who carried out a large construction project on behalf of the Government of the Marshall Islands including the Hall of Islands' Parliament and four story administration building to be constructed on Majuro Atoll. According to the original proposal put to the insurers by the contractors through their broker in 1989, the buildings were to have piled foundations, and the Quotation Slip also referred to piled foundations. The broker succeeded in obtaining full subscription to the proposal from the plaintiffs. However, there was no reference to the foundations in the policy. In 1990, a cheaper type of foundation known as shallow spread foundations rather than piled foundations were used by the defendants, and serious subsidence to the buildings under construction had occurred. The insured claimed against the insurers under the policy. The insurers' complaint was the insureds' failure of disclosure and misrepresentation of their intention to use spread foundations rather than piled foundations as stated in the original proposal. All parties accepted that the incorrect information on which the insurers underwrote the risk was presented by the insureds in error and with no bad faith. Nevertheless, the insurers claimed that non-disclosure and misrepresentation of the use of shallow spread foundations entitled them to avoid their liability.

In *St. Paul* case, unlike the *Pan Atlantic* case in which the undisclosed facts were material no matter what test of materiality was adopted, the result might be different, depending on the test of materiality. If the test of materiality is the anti-decisive influence test, i.e., something that the insurer is likely to know in assessing the risk, the change of the foundations was clearly material fact which the insurer would like to know. However, if the test is the decisive influence test, i.e., the information not disclosed has to have decisive effect on the insurer's decision, it is possible to say that the change of the foundations would not have decisive effect, because, in practice, it is likely that the insurer would still insure with the same premium in this situation. In fact, there is certainly no evidence in practice that the premium would be different in this situation. In practice, it has been said that the use of spread foundations decreases the

risk of accidents occurring during the construction process, but increases the risk of subsidence damage, whereas the pile foundations is a much more complicated construction method. Therefore, in some way, it is possible to say that the pile foundations could give rise to a more risky situation and the change of the pile foundations to the spread foundations would be in some sense reduction of the risk. Likewise, in practice, it would appear that there is no particular reason why the premium should have gone up. In addition, it would appear that the change of the foundation does not have a decisive effect on the insurer's decision in assessing the risk in this situation. Likewise, the St. Paul case seems to be a good example to show the different results of applying two different tests of materiality.

5.3.4.2. AT FIRST INSTANCE

Potter J. applied the law as it stood at that time and unhesitatingly accepted the principles set out by the Court of Appeal's judgments in C.T.I. case and Pan Atlantic case. This case became one of the earliest reported non-disclosure and misrepresentation cases following the Court of Appeal's judgment in the Pan Atlantic case. Consequently, Potter J. was concerned with the position not of the actual insurer but of the prudent insurer. Potter J. had no objection to the formerly established view that the inducement of the particular insurer by non-disclosure and the decisive influence of non-disclosure upon an underwriter's judgment were not necessarily required in order to avoid the policy. As to the test of materiality, he accepted Steyn L.J.'s formulation of the test of materiality that a fact is to be regarded as material if a prudent insurer would have regarded the risk as increased had he been aware of that fact.¹⁵¹

Applying this test of materiality to the facts in question, Potter J. held that the change of the nature of the foundations was a material fact, in that it probably tended to increase

¹⁵¹[1993] 2 Lloyd's Rep. 503, at pp. 512-513 ; Also see, *Newbury International Ltd v. Reliance National Insurance Co. Ltd* [1994] 1 Lloyd's Rep. 83

the risk, although the insurers would not necessarily have charged a higher premium had the facts been disclosed. Accordingly, he gave his decision in favor of the plaintiffs, saying that ;

"I do not doubt that a prudent underwriter, apprised of the intended change in foundation design proposed, would have regarded such change as tending to increase the risk he was being called upon to insure. That is all that is necessary for the plaintiffs to succeed on the grounds on non-disclosure."¹⁵²

5.3.4.3. COURT OF APPEAL

After the judgment of Potter J. was delivered, the House of Lords in Pan Atlantic case modified the law in this area. Consequently, the Court of Appeal in the St. Paul case had to consider the two important principles set out in the decisions of the House of Lords in the Pan Atlantic case. Therefore, what Evans L.J., who delivered the main judgment of the Court of Appeal in the St. Paul case, had to decide was not whether Potter J. had applied the law correctly, but whether the law as it now stood would affect Potter J.'s decision. Evans L.J. said that the formulation of the test of materiality provided by Lord Mustill in Pan Atlantic case should be regarded as something which is correctly stating the law.¹⁵³ Therefore, all matters are material which would have been taken into account by the underwriter when assessing the risk which he was consenting to assume. Evans L.J. also thought that material factors were not limited to those which increase the risk consented to by underwriters. It means that he disagreed with Steyn L.J.'s test of materiality in Pan Atlantic case.¹⁵⁴ Evans L.J. held that the intention to use spread foundations (as opposed to piled one) was a material fact, even though he found that underwriters in this case would never have been concerned with the proposed type of foundations. Likewise, the anti-decisive influence test was adopted in the Court of Appeal.

¹⁵²Ibid., at p. 516

¹⁵³(1995) 45 Construction Law Reports 89, at p. 100

¹⁵⁴Evans L.J. also gave further specific reasons why Steyn L.J.' test of materiality was unnecessary. See, Ibid., at pp. 101-104

It would appear that the Court of Appeal's adoption of the anti-decisive influence test is related to the issue of the inducement of the actual insurer. The advocates of the anti-decisive influence test believe that the question of the decisive influence test applied to the prudent underwriter is strongly influenced by the decision of the Court of Appeal in the C.T.I. case, which clearly rejected the role of the actual underwriter and of the requirement of inducement. In other words, the question of whether it is necessary for the insurer to show that the prudent insurer would have been decisively influenced in his judgment seems to be related to the traditional view that the actual inducement of the actual insurer was not required. It would appear that the issue of the decisive influence test is in substance very similar to the question of inducement, and the reason of applying it to the prudent underwriter is that the role of the actual underwriter, to whom it is more easily applied, had been ignored. However, the role of the actual insurer and the requirement of inducement are now approved by the House of Lords in Pan Atlantic case, therefore there is no practical need to define materiality in terms of decisive influence. Consequently, Evans L.J held that the anti-decisive influence test was the correct interpretation.

5.3.5. CRITICISM OF ANTI-DECISIVE INFLUENCE TEST

Is the House of Lords' formulation of the test of materiality in the Pan Atlantic case really narrower than the much criticized test of materiality in the Court of Appeal in the C.T.I. case? It is very difficult to see any substantial difference between the test of materiality in the C.T.I. case (a fact which the prudent insurer would have wanted to be aware of) and the test which the House of Lords in Pan Atlantic and the Court of Appeal in the St. Paul case adopted (a fact which would have been taken into account by the underwriter when assessing the risk).

As Steyn L.J. in the Court of Appeal in the Pan Atlantic case pointed out,¹⁵⁵ the decision of the Court of Appeal in the C.T.I. case on the issue of the interpretation in s. 18(2) of the M.I.A. 1906 has been unpopular not only in the legal profession but also in the insurance market. According to the anti-decisive influence test, the word "would" in the wording of s. 18(2) seems to have been replaced with the word "might". Therefore, the insured must disclose everything which would have had an impact on the formation of a prudent insurer's opinion and on his decision-making process, or which a prudent insurer would have liked to know about when making decision, although that information could be discarded later by him as unimportant. Consequently, the insured has to disclose all circumstances which might influence the prudent insurer or which have a tendency to affect the risk or premium level. Considering the fact that any breach of the insured's duty of utmost good faith renders the contract voidable at the option of the insurer, this anti-decisive influence test prompted criticism on the basis that an imprudent insurer could too easily escape the consequences of poor underwriting.¹⁵⁶

This anti-decisive influence test is undoubtedly unduly harsh on the insured who has been already suffering from the doctrine of the duty of disclosure which is specially required in insurance contracts, unlike the general law of contract.¹⁵⁷ The anti-decisive influence test imposes the duty upon the insured to disclose virtually endless and unlimited facts, although these information might be ultimately discarded by the underwriter as inconsequent. The law is already sufficiently kind to insurers who seek to avoid contracts for innocent non-disclosure. It would appear that the anti-decisive influence test fails to consider the difference in importance in terms of the weight of

¹⁵⁵[1993] 1 Lloyd's Rep. 496, at p. 504

¹⁵⁶H. Bennett, "Utmost Good Faith in the House of Lords", (1995) 111 L.Q.R. 181, at p. 182

¹⁵⁷This harshness was pointed out even by the judges who gave their decisions in favour of the insurer. See, for example, MacKenna J.'s regret in *Lambert v. Co-operative Insurance Society Ltd* [1975] 2 Lloyd's Rep. 485, at p. 491 ; Also see, *Glicksman v. Lancashire and General Assurance Co.* [1927] A.C. 139, at pp. 143-144 ; *Provincial v. Morgan* [1932] A.C. 240, at p. 252

influence during the decision-making process. It is almost impossible for the insured to know what might influence a prudent insurer's decision-making process and to expect to know in detail the current practice, attitudes and policies of the prudent insurers in the city of London.

The interpretation of the test of materiality should be limited and confined. If the undisclosed fact would have been discarded later by the prudent insurer in determining whether or not to accept the risk, even though the prudent insurer would have been generally interested in that information, the defense of non-disclosure of this information by the insurer should be failed. The key issue for determining materiality has to be whether a prudent insurer would have been *actually affected* by that information in fixing the premium or in determining whether he will take the risk.¹⁵⁸ This narrow interpretation is more persuasive under the phrase "...*would* influence the judgment of a prudent insurer..." in s. 18(2) of the M.I.A. 1906.

The criticism relates to the principle. According to the broad test, the absurd consequence that an insurer may be able to repudiate his liability even where the risk is exactly the same as the risk actually presented to him might occur, because all that is required by the broad test is that an insurer merely shows that the prudent insurer would have wished to know of the information when making his decision. It is submitted that non-disclosure is blamed, because the breach of the duty of disclosure vitiates the consent of the insurer. If the prudent insurer would have accepted the risk at the same premium and on the same terms, it must be because, so far as he is concerned, the risk is the same. It would be very difficult to say that the insurer's consent has been vitiated when the same contract on the same terms or on the same premium would have been

¹⁵⁸The insurer's highly developed networks of collecting information in modern insurance industry, compared with the past, may be said to be another reason of preference for the narrow test.

made, although the prudent insurer had been aware of the information.¹⁵⁹ If the insurer's consent has not been vitiated, on what other juristic basis could he claim the right to avoid the contract? It seems to be impossible to describe the circumstance undisclosed as material when it would not have mattered to the prudent insurer whether the circumstance was disclosed or not. The nature of non-disclosure, which has been said to vitiate the consent of the contracting party, seems to have disappeared as a result of the broad test.

This broad interpretation is also contrary to the original purpose of the duty of disclosure which was pointed out by Lord Mansfield in *Carter v. Boehm*¹⁶⁰. Lord Mansfield said ;

"Although the suppression should happen through mistake... yet still the underwriter is deceived, and the policy is void; because the risque is really different from the risque understood and intended to be run, at the time of the agreement... The question... must always be whether there was, under all the circumstances at the time the policy was underwritten, a fair representation; or a concealment; fraudulent, if designed; or though not designed, varying materiality the object of the policy, and changing the risque understood to be run."

It would appear that the underlying intention of Lord Mansfield was to make it hard to set a contract aside for non-disclosure by linking the non-disclosure to the risk insured against. In other words, the key point for the issue of non-disclosure should be whether the risk with the information in question is different from the original risk understood and intended to be run at the time of the agreement. This principle seems to have remained in place in general contract law.¹⁶¹ However, the broad interpretation in insurance contracts seems to be inconsistent with this principle, because it is now quite

¹⁵⁹This is inconsistent with the principle in the general law of contract, in particular as regards misrepresentation. ; *J.E.B. Fasteners Ltd v. Marks, Bloom & Co.* [1981] 3 All E.R. 289 ; H. Bennett, *Ibid.*, at pp. 513, 514 and 516-517

¹⁶⁰(1766) 3 Burr. 1905, at p. 1909-1911

¹⁶¹*Hong Kong Fir Shipping Co. Ltd v. Kawasaki Kisen Kaisha Ltd* [1962] 2 Q.B. 26 ; *Cehave N.V. v. Bremer Handelgesellschaft m.b.H.* [1976] Q.B. 44 ; Also see, Misrepresentation Act 1967 s. 2(2)

possible for the insurer to avoid his liability more easily than ever for non-disclosure without the analysis of a different risk.

Another criticism is the inconsistency with precedent. It would appear that a large number of old cases are not helpful in relation to the question of the test of materiality, since the precise point does not seem to have arisen. Most of them were concerned with the question of whether "risk" meant only the likelihood of the peril insured against or whether it had a broader meaning including moral hazard. However, as Lord Lloyd in *Pan Atlantic* case pointed out, a large number of dicta in the cases which followed the principle established by Lord Mansfield in *Carter v. Boehm*¹⁶² seemed to show that disclosure of facts would have made an actual practical difference in the judgment of a prudent insurer in fixing the premium or in determining whether he will take the risk in relation to the test of materiality. In other words, they seemed to focus on what the insurers would have done, not on what they want to know. For instance, in *Stribley v. The Imperial Marine Insurance Co.*¹⁶³, Blackburn J. said ;

"I think the test is, whether a fair and reasonable underwriter,... would say, 'I think this is a speculative risk, which I will either decline to take, or if I do take, it shall be at a greater premium than is usual.'"¹⁶⁴

Also, he said in *Ionides v. Pender*¹⁶⁵ ;

"... it would be too much to put on the assured the duty of disclosing everything which might influence the mind of an underwriter. Business could hardly be carried on if this was required."

These passages clearly show a principle that a fact is not material where the prudent insurer fails to show that the new information would have made any actual practical

¹⁶²(1776) 3 Burr. 1905

¹⁶³(1876) 1 Q.B.D. 507

¹⁶⁴*Ibid.*, at p. 512

¹⁶⁵(1874) L.R. 9 Q.B. 531, at p. 539

difference to an evaluation of the risk in relation to fixing the premium or determining whether he will take the risk. In other words, it is not sufficient for the prudent insurer to just say that he would have taken into consideration the information.

As regards old authorities which were relied on by some courts in order to support the broad interpretation,¹⁶⁶ it would appear that the nature of the facts of some of them are not relevant to discussion of the test of materiality, or the underlying principles of those decisions were misunderstood. For example, *Rivaz v. Gerussi*¹⁶⁷ and *Tate & Sons v. Hyslop*¹⁶⁸ seem to have established a principle that materiality is not limited to the insured risks only, but covers everything which would affect the mind of underwriters so as to decline the business or increase the premium. Therefore, it would appear that these decisions showed a different principle from the broad interpretation.

Also, in *Traill v. Baring*,¹⁶⁹ the duty in question was not the positive duty of disclosure imposed on the insured from the outset. The duty in question in this case was the representor's duty to correct his former statements. The judgment of Knight Bruce L.J. clearly showed his preference for the narrow test¹⁷⁰, whereas Turner L.J.'s judgment seemed to support the broad test¹⁷¹. Therefore, it cannot be said that this case supports only the broad interpretation. Likewise, earlier cases on which the Court of Appeal in the C.T.I. case heavily relied in relation to the issue of the test of materiality in non-disclosure do not provide substantial support for the anti-decisive influence test.

¹⁶⁶For instance, *Traill v. Baring* (1864) 4 De G.J. & S. 318 ; *Rivaz v. Gerussi* (1880) 6 Q.B.D.222 ; *Tate v. Hyslop* (1885) 15 Q.B.D. 368 ; *Mayne Nickless Ltd v. Pegler* [1974] 1 N.S.W.L.R. 228 ; *Marene Knitting Mills Ltd v. Greater Pacific General Insurance Ltd* [1976] 2 Lloyd's Rep. 631

¹⁶⁷(1880) 6 Q.B.D.222

¹⁶⁸(1885) 15 Q.B.D. 368

¹⁶⁹(1864) 4 De G.J. & S. 318

¹⁷⁰*Ibid.*, at p. 326

¹⁷¹*Ibid.*, at p. 330

It is also submitted that the advocates of the anti-decisive influence test misinterpreted the meaning of the decisions of the two important cases on which Lloyd J. at first instance of the C.T.I. case¹⁷² heavily relied in formulating the test of materiality to support the decisive influence test. The first case is Mutual Life Insurance Co. of New York v. Ontario Metal Products Ltd (hereafter Ontario case)¹⁷³ This case concerned the failure by an insured to disclose a medical check-up to the insurance company and the interpretation of section 156(3) and (4) of the Ontario Insurance Act 1914.¹⁷⁴ Lord Salvesen in this case defined the test of materiality as follow ;

"... it is a question of fact in each whether if the matters concealed or misrepresented had been truly disclosed they would, on a fair consideration of the evidence, have influenced a reasonable insurer to decline the risk or to have stipulated for a higher premium."¹⁷⁵

The advocates of the anti-decisive influence test criticized Lloyd J., because they thought that the trial judge had misinterpreted the meaning of this decision and this case could not be an authority for the present purpose. This is because, they thought, this case concerned the construction of a special section in a Canadian statute which the M.I.A. 1906 does not contain. Kerr L.J., in the Court of Appeal in the C.T.I. case said ;

"But these remarks [Lord Salvesen's definition of materiality] were made in the context of construing a section in a Canadian statute which referred to 'a material misrepresentation by which the insurer was induced to enter into the contract'"¹⁷⁶

¹⁷²[1982] 2 Lloyd's Rep. 178

¹⁷³[1925] A.C. 344

¹⁷⁴See, section 156 of the Ontario Insurance Act 1914 (3) The proposals or application of the assured shall not as against him be deemed a part of or considered with the contract of insurance except in so far as the Court may determine that it contains a material misrepresentation by which the insurer was induced to enter into the contract. (4) No contract shall be avoided by reason of the inaccuracy of any such statement unless it is material to the contract...

¹⁷⁵Ibid., at p. 351

¹⁷⁶[1984] 1 Lloyd's Rep. 476, at p. 495 ; Also see, at p. 528 (Stephenson L.J.)

In other words, the advocates of the broad test argue that this case mainly focused on the particular word 'inducement' of the statute and on the fact that this case dealt with an inducement of the *actual insurer* who entered into the contract, which was required by the Canadian statute. Therefore, it has been said that this case was not relevant to discussion of general materiality in non-disclosure in which the standard is a prudent insurer test. A similar interpretation as to the decision of Ontario case existed before. In *Mayne Nickless Ltd v. Pegler*¹⁷⁷, Samuels J. expressed his own view on the decision of the Ontario case after analysis of Lord Salvesen's definition, saying ;

"These dicta suggest on their face that an insurer to establish materiality must prove that he would have refused to issue the policy if he had been told the fact not disclosed. But so far as I know this has never been the law and I do not think their Lordships in the *Ontario Metal Products* case intended to suggest that it was. There they were dealing with a particular provision of the Ontario Insurance Act..."¹⁷⁸

It would appear that it is the advocates of the anti-influence test who misunderstand the meaning of the decision of the Ontario case. The decision concerned not only a special provision of Canadian statute, but also the general test of materiality in non-disclosure and misrepresentation. In this case, the appellants' counsel suggested that the test was whether, if the fact concealed had been disclosed, the insurers would have acted differently, either by deciding the risk at the proposed premium or at least by delaying consideration of its acceptance until they had consulted the assured's doctor. As to the test of materiality, the Board accepted the first half of this proposition, rejecting the second one ;

"If the former proposition were established in the sense that a reasonable insurer would have so acted, materiality would, their Lordships think, be established, but not in the latter if the difference of action would have been delay or delay alone. In their view, it is a question of fact in each case whether, if the matters concealed or misrepresented had been truly disclosed, they would, on a fair consideration of the evidence, have influenced a reasonable insurer to decline the risk or to have stipulated for a higher premium."¹⁷⁹

¹⁷⁷[1974] 1 N.S.W.L.R. 228

¹⁷⁸*Ibid.*, at p. 238

¹⁷⁹[1925] A.C. 344, at pp. 351-352

From this passage, it is clear that the Board decided that something which the insurers would have wanted to know or would have taken into account is not by itself material, unless it would have led to a different action of the insurers. In other words, the decisive influence test was adopted. If Lord Salvesen had considered only the statute, as the Court of Appeal in the C.T.I. case insisted, there would have been no demand to refer to the "reasonable insurer" test at all in defining the test of materiality.¹⁸⁰

What he did in this case was to separate two issues. Firstly, he considered the relevant test for materiality in insurance contracts, clearly pointing out that the *actual influence of the prudent insurer* was the essential point for determining materiality. After that, he took into account the inducement of the actual insurer in the particular provision of the Canadian statute in question. It is clear that, as far as the general test of materiality is concerned, the actual influence of the prudent insurer is the crucial factor in determining what is material.¹⁸¹ If the prudent insurer were to say that the fact, if disclosed, would have induced him to reach a different judgment on the risk, it could be described as material. Lord Salvesen's separation of the two issues was overlooked and the meaning of the decision of the Ontario case was misunderstood by those who support the anti-decisive influence test. Likewise, this case surely remains the leading authority on the issue of the decisive influence test of materiality. This interpretation was supported by Lord Lloyd in the Pan Atlantic case and by a series of decisions.¹⁸²

¹⁸⁰H. Brooke, *Ibid.*, at p. 446 ; H. Yeo, "Common Law Materiality - an Australian Alternative", [1990] J.B.L. 97, at p. 100

¹⁸¹This is very clear from a passage of Lord Salvesen after he considered a test of materiality formulated by counsel for the insurer in question. See, [1925] A.C. 344, at pp. 350-352

¹⁸²Southern Cross Assurance Co. Ltd v. Australian Provincial Assurance Association Ltd (1939) 39 S.R. (N.S.W.) 174, at pp. 187-188 ; Pan Atlantic Insurance Co. Ltd v. Pine Top Insurance Co. Ltd [1994] 3 W.L.R. 677, at pp. 725-727 ; The advocates of the anti-decisive influence test made the same mistake in understanding the real meaning of the decision in Zurich General Accident and Liability Insurance Co. Ltd v. Morrison [1942] 2 K.B. 53.

Likewise, the advocates of the anti-decisive influence test misunderstood the real meaning of these two important cases, and were wrong to castigate the trial judge's reliance on these cases to support his decisive influence test for materiality. In conclusion, the result of the C.T.I.'s test has tilted the balance in favor of the insurers to an extent which makes it possible for the insurers to avoid insurance contracts on the flimsiest grounds and it imposes an obligation on the insured to disclose virtually endless material about the insured's past. This anti-decisive influence test would give carte blanche to the avoidance of insurance contracts on vague grounds of non-disclosure supported by vague evidence even though the disclosure would not have made any difference.

The Court of Appeal in the Pan Atlantic case refined the test of materiality, and established the necessary degree of influence which non-disclosure must have. It held that the question on materiality should be whether the prudent insurer would view the undisclosed material as probably tending to increase the risk. In other words, a fact is material if it would cause a prudent insurer to appreciate that the risk was different from that actually presented to him. This test involves a consideration of the fact that avoidance for non-disclosure is the remedy provided by law because the risk actually presented to the prudent insurer is different from the true risk, and this test seems to be consistent with the rationale of the doctrine of non-disclosure pointed out by Lord Mansfield in Carter v. Boehm.¹⁸³

Considering the underlying principle shown in a series of decisions after Carter v. Boehm, one question - "is the risk materially different from that which was presented to underwriters when they wrote the policy by reason of the non-disclosure of the fact?" - should be considered in order to determine materiality of undisclosed facts. The

¹⁸³(1776) 3 Burr. 1905, at pp. 1909-1911

undisclosed fact must be one which changes the risk. In other words, the disclosure of a fact must have made the risk originally understood to be covered at the time of agreement different.¹⁸⁴ Therefore, it is correct to link the test of materiality to the risk in question, and this modified formulation seems to be consistent with the rationale of the duty of disclosure. This restricted view could impose some limitations on the unduly wide duty of disclosure by the insured. The Court of Appeal in *Pan Atlantic* insisted that this test would provide a fairer and more balanced solution than the former test in the *C.T.I.* case. In some sense, the difference in risk test does seem to provide a higher standard than the criterion of mere impact on the mind of the prudent insurer in weighing up the risk.

However, the Court of Appeal in the *Pan Atlantic* case also made it clear that the changed test did not mean that it was necessary to prove that the underwriter would have taken any different decision about the acceptance of the risk. In other words, if a prudent underwriter would regard the undisclosed fact as tending to increase the risk, the insurer might avoid the policy, whether or not he would have declined the risk or charged an increased premium. This is a disappointing judgment. Consequently, the judgment did not go far enough to remove the criticisms of the *C.T.I.*'s test and substantial inequities still remain. In fact, the insured lost at first instance of the *St. Paul* case in which this modified test of materiality was applied. Unless the decisive influence on the decision of the prudent insurer is approved, the test of materiality in the Court of Appeal in the *Pan Atlantic* case has its own limitation and weakness, and consequently cannot change the current situation.

The decisive influence test also seems to be closer to the real spirit of the words in s. 18(2). It is submitted that the ordinary meaning of "influence" is to "alter", and the word "judgment", in many cases, means "the insurer's ultimate decision", not the insurer's

¹⁸⁴A fact which decreases the risk is deemed not to be material. Therefore, the question is whether a fact undisclosed is likely to increase the risk or not.

thought processes, in a commercial context. Therefore, "judgment" cannot be said to be influenced unless it is altered. Considering the existence of the word "would" in s. 18(2) of the M.I.A. 1906, along with the ordinary meanings of those two words - influence and judgment -, it is not enough to show that a prudent insurer *might* have declined the risk or charged an increased premium. It is necessary to show that he would either in fact have declined the risk, or charged an increased premium, and this is the obvious meaning of the words of the 1906 Act.

In addition, this decisive influence test should be adopted, considering the practicality of the test. The decisive effect test seems to be consistent with the purpose of the prudent insurer test - an objective test of materiality. This objective test should be clear and simple. The decisive effect test - a test which depends on what a prudent insurer would have actually done - seems to satisfy this requirement, whereas a test which only depends on what a prudent insurer would have wanted to know, or taken into account, in deciding what to do is likely to bring about some complications, particularly in the case of inadvertent non-disclosure.

The anti-decisive influence test argues that it is impossible to say that prudent insurer in general would have acted differently, had he been in possession of the information in question, because there is no absolute standard. However, prudent and experienced underwriters are just as likely to disagree about what they would want to know as about what they would have actually done. If an expert claims he would have wished to know but would have accepted the risk at the same premium even though he knew of the fact, it is almost impossible to test it. In fact, an expert evidence based on the decisive influence test can be much more clearly tested against his, and other prudent insurers' past conduct or decision with a clear and objective hindsight. In the case where there are conflicts of expert evidence as to the influence on the decision of the prudent insurer, based on the decisive influence test, the courts can resolve this problem relying on their experiences and standards of prudent underwriting.

It is true that this decisive influence interpretation may have a problem in practice. The insured may need a two-step process. Firstly, the insured has to decide whether a fact is influential or not. Then, secondly he has to decide whether or not it is decisively influential. However, the anti-decisive influence test requires the insured to disclose everything of relevance, which seems to be impossible and impractical. It cannot be supported. The existence of occasional practical difficulties in terms of evidentiary problem, if any, cannot be a justification for supporting the anti-decisive influence test. In terms of the need for certainty which is consistent with the objective test, the decisive influence test is more forceful.

The decisive influence test also seems to be consistent with the original purpose of the test of materiality based on the prudent insurer test. Until the middle of the 19th century, inducement of the actual insurer was all that was required in the test of materiality as a matter of common law. This situation left the insured at the risk of an insurer who acted unreasonably. Consequently, a lot of concern arose as to the insured's possible unjust burden and risk which would be placed on him if the materiality was to be decided only by the standard of the actual insurer. To resolve this concern, a requirement of materiality test based on the prudent insurer was newly introduced. Considering this purpose of introducing this new materiality test based on the prudent insurer, it is necessary that the prudent insurer as well as the actual insurer would have been induced to enter the contract. The anti-decisive influence does not seem to meet this purpose.¹⁸⁵

In conclusion, this decisive effect test does full justice to the expression of s. 18 of the M.I.A. 1906, and will mitigate the harshness of the current practice of the duty of disclosure. If the undisclosed fact would have been discarded later by the prudent insurer in determining whether or not to accept the risk, making no difference in his decision,

¹⁸⁵Kelly & Ball, at p. 89

the defense of non-disclosure of this information by the insurer should fail. The key issue for determining materiality should be whether a prudent insurer would have been *actually affected* by that information in fixing the premium or determining whether he will take the risk.

5.3.6. TEST OF MATERIALITY IN AUSTRALIA

5.3.6.1. GENERAL CONSIDERATION

It is worth briefly examining the Australian situation on the issue of the test of materiality. This is because the commencement of the Australian Insurance Contracts Act 1984 on 1 January 1986 has changed a lot of things on this issue. The duty of disclosure and the test of materiality are now governed by this act which has been said to provide a more even-handed approach to this issue. Firstly, the duty of disclosure by the insured has been narrowed. Under this act, the insured has a duty to disclose to the insurer every matter that is known to the insured, being a matter that (1) the insured knows to be relevant to the decision of the insurer whether to accept the risk and, if so, on that terms or (2) a reasonable person in the circumstances could be expected to know to be a matter so relevant. Secondly the concept of the prudent insurer has been abandoned in this act. Thirdly, the controversial issue of whether the inducement of the actual insurer, or the prudent insurer, or both is required becomes irrelevant in insurance contracts controlled by this new act. In addition, the recent decision of the New South Wales, Court of Appeal in Barclay Holdings (Australia) Pty Ltd v. British National Insurance Co. Ltd¹⁸⁶ (hereafter Barclay case), has produced a bold and an instructive decision, pointing out the injustice and harshness of the broad interpretation.

5.3.6.2. THE BARCLAY CASE¹⁸⁷

¹⁸⁶[1987] 8 N.S.W.L.R. 514

¹⁸⁷This case was not governed by the new act, since the facts of the case took place before the commencement of the day of this act. Therefore this case is one of the last few cases on the common law duty of disclosure in Australia.

This case concerned the interpretation of the test of materiality formulated by Samuels in *Mayne Nickless Ltd v. Pegler*¹⁸⁸ which had been generally regarded as the proper test in Australia before the new act came into force.

"a fact is material if it would have reasonably affected the mind of a prudent insurer in determining whether he will accept the insurance and if so, at what premium and on what conditions. The word 'reasonably' is necessary to maintain control over the evidence of possibly absurd stringent insurance practice."

This test was approved by the Privy Council in *Marene Knitting Mills Pty. Ltd v. Greater Pacific General Insurance Ltd*¹⁸⁹ It had been said that this test was ambiguous on the issue of the degree of influence. Therefore, the main task of the three judges in the Court of Appeal of Barclay case (Kirby P., Glass J.A. and Priestley J.A.) was to decide in what way this test should be interpreted and applied. Kirby J. interpreted this test in a narrow way, expressing his own opinion that the meaning of 'affected the mind of a prudent insurer' in Samuels' test is that only those considerations which will *ultimately determine* the insurer's decision whether to accept the risk and, if so, on what premium and on what condition should be regarded as material. His view was clearer in his later passage ;

"...the effect on the mind of the insurer... should be something more than the effect produced by information which the insurer would have been generally interested to have. If, though interested to have it, such information would not, in the end, have determined for a reasonably prudent insurer the acceptance or rejection of insurance, the setting of the premium or the attachment of conditions, there is not such effect on the mind as requires disclosure by the insured. The information, although of interest, is not material."¹⁹⁰

Glass J.A. analyzed the difference between Samuels' test and the C.T.I.'s test. The crucial difference is the time of decision. The C.T.I.'s test hints that the relevance of the

¹⁸⁸[1974] 1 N.S.W.L.R. 228, at p. 239

¹⁸⁹[1976] 2 Lloyd's Rep. 631, at p. 642

¹⁹⁰[1987] 8 N.S.W.L.R. 514, at p. 517 ; Kirby J. offered some reasons for his preference for the narrow view. see, *Ibid.*, at pp. 517-519. Most of these reasons were already discussed in the criticism of the anti-decisive influence test in this chapter.

facts is decided at the moment when the prudent insurer undertakes the investigation, whereas Samuels' test implies that the decision of materiality is decided at the moment when the prudent insurer is deciding whether or not to take the risk.

Glass J.A.'s analysis, which focused on the underwriter's decision-making process, clearly shows the harshness and injustice of the C.T.I.'s approach in practice. At the initial stage of the decision-making process, almost all information will be interesting to the underwriter who undertakes risk investigations. After this stage, some information will be discarded by the underwriter as immaterial, whereas other will still capture the attention of the insurer. Through this stage, the information which the insurer has obtained so far will be classified in the order of significance. Then, in the final stage, the insurer will decide, with the information which has still influenced the mind of the insurer up to the last stage, whether to accept the risk, and if so, on what terms, conditions and premium.

If the broad test is applied, it is not difficult to expect that the insurer can repudiate his liability on the defense of non-disclosure of a fact at the initial stage (undertaking risk investigations), which will eventually turn out to be harmless and inconsequential in fixing the premium or in determining whether he will take the risk at the final decision-making stage. It is clear that the broad test is absurd and irrational, and tends to favor the insurer too much. Glass J.A., with whom Priestley J.A. agreed, unhesitatingly supported the narrow view, confining the scope of the common law duty of disclosure to the ultimate decision-making stage (final stage). He clearly objected to the so called "mere impact theory". In other words, according to his reasoning, the judgment of the insurer in fixing the premium or risk acceptance *must have been actually influenced*, and this real influence is possible only at the final decision-making stage. This interpretation

seems to be consistent with the original purpose of the principle of the duty of disclosure.¹⁹¹

From the above reasoning of the Court of Appeal in the Barclay case, it is clear that the Samuel's test in *Mayne Nickless Ltd v. Pegler*¹⁹² should be interpreted in a narrow and confined way. Furthermore, Samuels added the word 'reasonably' to the word 'affected' in order to prevent the possible wide interpretation of the word 'affected'. Likewise, the decision of the Barclay case has produced a more sensible and practical approach on this issue. This fresh reasoning and interpretation might provide a guide-line on this matter for the English jurisdiction where the common law duty of disclosure has been interpreted in favor of the insurer and the hope of statutory reform is very slim. However, the English courts were not strongly influenced by this Australian decision when they delivered their decisions in the Pan Atlantic case and the St. Paul case in recent years.

Bearing the mutual nature of the duty of disclosure in mind, it is undesirable to protect one contracting party unduly, compared with the other, which could be the result of the anti-decisive influence test. In conclusion, an insurer should be allowed to rely on a defense of non-disclosure of material fact only if it *would have actually influenced* a prudent insurer in fixing the premium and in determining whether he will take the risk.

¹⁹¹See, the statement of Kirby P. Ibid., at p. 518 "The best and most rational basis for such limits is provided by reference to the purpose of the rule requiring disclosure. This is not to fix the insured with an obligation to reveal every circumstance in the past that might conceivably be of interest to the insurer and its officers. Instead, it is to provide the insurer with that material which enable him to make the critical decisions." ; P. North, "Law Reform; process and problem", (1985) 101 L.Q.R. 338, at pp. 348-350 ; H. Yeo, "Common Law Materiality - an Australian Alternative" [1990] J.B.L. 97, at pp. 100-104 ; A. Scotford, "Chipping Away at *C.T.I. v. Oceanus*", [1988] L.M.C.L.Q. 30 at pp. 31-34

¹⁹²[1974] 1 N.S.W.L.R. 228, at p. 239

CHAPTER. 6 INTERPRETATIONS OF ADDITIONAL REQUIREMENT OF ACTUAL INDUCEMENT

6.1. INTRODUCTION

It is beyond doubt that actual inducement is a distinct requirement for the establishment of an actionable misrepresentation in the general law of contract, but this issue has rarely been discussed in the courts in relation to non-disclosure in insurance contracts since the enactment of the M.I.A. 1906. However, this requirement of actual inducement is now fully accepted along with the requirement of materiality in non-disclosure and misrepresentation in insurance contracts. The House of Lords in the Pan Atlantic case unanimously held that an underwriter had to show that he had actually been induced by the non-disclosure to enter into the policy on the relevant terms before he could avoid a contract for non-disclosure of a material circumstance.

Although this additional requirement is welcomed in terms of the protection of the insured, two important questions remain. The first one is what are the contents of inducement. The precise analysis of this concept is important in carrying out this new requirement in practice. It is inevitable that insurance contract law should rely heavily on the principle of this concept in the general law of contract, considering the lack of authorities as to this new requirement in insurance contracts. In relation to this point, Lord Mustill in the Pan Atlantic case held that the meaning of inducement in misrepresentation in the general law of contract should be applied to the misrepresentation in insurance contracts, saying that "... using 'induced' in the sense in which it is used in the general law of contract."¹ It has been said that this proposition in misrepresentation applies equally to the issue of non-disclosure, considering the similar

¹[1994] 3 W.L.R. 677, at p. 712

scope and overlaps of the two duties and the practice that misrepresentation and non-disclosure commonly appear in tandem in pleadings.²

The second question is even more important. To what extent will the requirement of inducement give benefit to the insured in practice? In other words, will the requirement of inducement really help the insured? This question is closely linked with another question - how to interpret the concept of presumption of inducement. It is because the burden of proof of inducement will be passed to the insured from the insurer as a result of the application of the presumption of inducement. (in fact, the burden of proof of non-inducement) Therefore, the success of the requirement of inducement in practice in terms of the protection of the insured largely depends on who has the onus of proof, in other words, how narrowly or widely the presumption of inducement will be applied in practice. Unfortunately, the House of Lords in the *Pan Atlantic* case has not given answers to these crucial questions.

The following discussion will be divided into two parts. The concept and contents of inducement in the general law of contract will be firstly discussed. Then, analysis as to the requirement of materiality in the general law of contract will be followed, since the evidentiary role of materiality is closely related with the question of inference of actual inducement, which would be applied to insurance contract law. The second part, after the analysis of the general law of contract, will deal with the question how to interpret the new requirement of inducement in insurance contract law. The crucial issue of the presumption of inducement and the question of the relationship between materiality and inducement in insurance contract law will be examined. In relation to them, the possible answer to the question of under what circumstances the presumption of inducement can be allowed in practice will be explored, and finally an inevitable question - in what ways the insured can rebut the presumption of inducement - will be also analyzed.

²For more detailed discussion, see Ch.2 of this thesis. Also see, Merkin & McGee, at A.5.3-07

6.2. GENERAL LAW OF CONTRACT

6.2.1. INDUCEMENT

6.2.1.1. GENERAL CONSIDERATION

To establish an actionable misrepresentation, the representation must actually induce the contract, i.e., it must induce the actual representee to enter into the contract with the representor. Even if a reasonable man would have been induced by the misrepresentation, the misrepresentation is not actionable if the actual representee was not induced in fact. This is perhaps the most important aspect of an actionable misrepresentation. This actual inducement must be proved by the representee, irrespective of materiality which is another alleged requirement. The concept of inducement is a question of fact and distinct from the concept of materiality.³ Sometimes, however, the consideration of inducement becomes unnecessary in practice as a result of a special term, an express condition or warranty in the contract in question.

There are two factors which constitute inducement. The existence of the representor's intention to induce is the first one. The second factor is the actual result of inducing the representee to alter his position. These two factors should be proved or imputed altogether. In other words, proof of one factor without the other cannot establish an actionable misrepresentation.

6.2.1.2. INTENTION TO INDUCE

The analysis of inducement is concerned with the state of mind of the representee to the contract in question. However, the consideration of the state of mind of the representor is also required in relation to the inducement. The existence of the representor's intention to induce should be alleged and proved to establish an actionable misrepresentation by

³*Smith v. Chadwick* (1884) 9 App. Cas. 187, at p. 196

the representee.⁴ It is not every false statement by which a person is in fact induced to alter his position for the worse which gives a right of action. The representor, either in fact or in contemplation of law, must have an express intention to induce the actual representee to the contract in question, or a class of which he forms one, to rely on and to act on the representation in a particular manner. In other words, foreseeability of the probability that the representee or class of person will be induced by the representation should be required of the representor.⁵ Without this requirement - the representor's intention to induce -, there might be floods of suits. This point is well illustrated by Lord

Denman C.J. in *Barley v. Walford*⁶ ;

"...if every untrue statement which produces damages to another would found an action at law, a man might sue his neighbor for ... having a conspicuous clock too slow, since the plaintiff might be thereby prevented from attending to some duty, or acquiring some benefit."⁷

The requirement of the representor's intention to induce is clearly applied to an action alleging fraud against the representor.⁸ However, despite lack of judicial statements as regarding this point, it may be said that this requirement is also applied to an action

⁴*Attwood v. Small* (1838) 6 Cl. & Fin. 232 ; *Barley v. Walford* (1846) 9 Q.B. 197 ; *New Brunswick and Canada Railway and Land Co. v. Conybeare* (1862) 9 H.L. Cas. 711 ; *Peek v. Gurney* (1873) L.R. 6 H.L. 377 ; *Smith v. Chadwick* (1884) 9 App. Cas. 187 ; *Salaman v. Warner* (1891) 65 L.T. 132 ; *Andrews v. Mockford* [1896] 1 Q.B. 372 ; *Gordon v. Street* [1899] 2 Q.B. 641 ; *Baty v. Keswick* (1901) 85 L.T. 18 ; *Sleigh v. Glasgow and Transvaal Options Ltd.*, 1904, 6 F. (Ct. of Sess.) ; *Tackey v. McBain* [1912] A.C. 186 ; *Bradford Third Equitable Benefit Building Society v. Borders* [1941] 2 All E.R. 205

⁵G. Spencer Bower, *The Law Relating to Actionable Misrepresentation*, (3rd ed. by A. Turner, 1974), Butterworths, at paras. 117 (hereafter *Actionable Misrepresentation*) ; *Halsbury's Laws*, Vol. 31, at para. 1071

⁶(1846) 9 Q.B. 197, at p. 208

⁷Also see, *Gerhard v. Bates* (1853) 2 E.& B. 476, at p. 485 ; *Thiodon v. Tindall* (1891) 65 L.T. 343, at p. 348

⁸*Thom v. Bigland* (1853) 8 Ex. 725, at p. 731 ; *Edgington v. Fitzmaurice* (1885) 29 Ch.D. 459, at pp. 479 and 482 ; *Peek v. Derry* (1887) 37 Ch.D. 541, at pp. 585-587 ; *Bradford Third Equitable Benefit Building Society v. Borders* (1941) 2 All E.R. 205, at p. 211 ; *Commercial Banking Co. v. R H Brown & Co.* (1972) 46 A.L.J.R. 297, at p. 300

which is involved with a non-fraudulent representor, considering the fact that the concept of intention is different from that of fraud.⁹

6.2.1.3. INFERENCE OF INTENTION

In many cases on the issue of misrepresentation in the general law of contract, the representor's intention to induce may be inferred from the circumstances of the case in which the representation was made. For example, where a representation is material because of the special characteristics of the particular representee which are known to the representor, the intention of the representor will be inferred by showing that the representor knew of the representee's idiosyncrasies when he made the representation to the representee. It is because the representee has thereby shown that the representor must have actually intended to induce him in the contract. The intention to induce is also presumed where the representor intentionally used some expressions in his representation in question which are calculated to induce a person in the circumstances of the case to act as the representee did, or where the nature of his words in the representation is to induce a normal person to take an action as the representee did in the case.

In addition, if a representation, which would be necessarily, naturally or probably misleading, was made by the representor, he, under this circumstance, is presumed to intend the necessary or natural consequences of his own words and acts, and the *evidentia rei* would therefore be sufficient without other proof of intention.¹⁰ The same implication can be found in Smith v. Chadwick¹¹ ;

⁹Fraud is decided by the representor's knowledge or belief, not by his intention or purpose.

¹⁰Coaks v. Boswell (1886) 11 App. Cas. 232, at p. 236

¹¹(1884) 9 App. Cas. 187, at p. 190

"... in an action of deceit, it is the duty of the plaintiff to establish two things; first, actual fraud, which is to be judged of by the nature and character of the representations made, considered with reference to the object for which they were made, the knowledge or means of knowledge of the person making them, and the intention which the law justly imputes to every man to produce those consequences which are the natural result of his acts : and secondly, he must establish that this fraud was an inducing cause to the contract ; for which purpose it must be material, and it must have produced in his mind an erroneous belief, influencing his conduct."¹²

There is no doubt that the consideration of the representor's words, actions and the circumstances of the case in question is crucial for inference of intention. In relation to the consideration of the circumstances, it seems to be related with the concept of materiality. It has been said that a representor is more likely to have intended to induce his opponent in the contract, if his representation is a material one, considering the fact that an ordinary man is more likely to have been induced by a material representation rather than an immaterial one.

The above-mentioned expressions in relation to the inference of intention - "*calculated* to induce a reasonable man to act", "*natural* results of the representor's acts" and "*necessary, natural or probable* consequences of the representor's own words and acts" - can be used to describe the concept of materiality, which is another alleged requirement to establish an actionable misrepresentation. Likewise, one of the evidentiary role of the element of materiality is concerned with the inference of intention to induce. In other words, the issue of the inference of the representor's intention is closely related with the question of materiality, and the authorities for the question of materiality are often cited for the issue of presumption of intention. In practice, in most cases as to misrepresentation, the proof of intention to induce occupies little place in the courts as a result of the inference of intention to induce.¹³

¹²Also see, *Polhill v. Walter* (1832) 3 B. & Ad. 114, at pp. 123-124 ; *Arnison v. Smith* (1889) 41 Ch.D. 348, at p. 372 ; *Wilkinson v. Downton* [1897] 2 Q.B. 57, at p. 59

¹³*Actionable Misrepresentation*, at para. 118

6.2.1.4. ACTUAL INDUCEMENT

Even though it is shown that the representor actually or presumptively intended to induce the representee, the misrepresentation is not actionable if the intention fails of its effect, i.e., the resultant alteration of the representee's position. Proof of the representor's intention to induce should be supported by another proof of his intention's effect and result. In other words, the element of inducement is fulfilled by showing the result of inducing the representee to alter his position for the worse. A mere alteration of his mind is not enough. The meaning of alteration of his position is to effect a voluntary change in his material interests or situation.¹⁴

This actual inducement is the perhaps the most important aspect to establish an actionable misrepresentation. The burden of proof lies on the representee. This requirement of the ultimate result of intention was shown by Lord Brougham L.C. in *Attwood v. Small*¹⁵ ;

"... that general fraudulent conduct signifies nothing; ... that an intention and design to deceive may go for nothing, unless all this dishonesty of purpose, all this fraud, all this intention and design ... not only connected with the particular transaction, but must be made to be the very ground upon which this transaction took place, and must have given rise to this contract."¹⁶

There are some situations where the representee will be unable to show that the representation in question actually induced the contract. Where the representee was unaware of the existence of the misrepresentation, it will have no legal effect. For instance, if the representee, who claims that he has been induced to purchase shares by a misrepresentation in the reports as to the accounts of the company, is unable to show

¹⁴*Halsbury's Laws*, Vol. 31, at para. 1079

¹⁵(1838) 6 Cl. & Fin. 232, at pp. 447-448

¹⁶Also see, *Bellairs v. Tucker* (1884) 13 Q.B.D. 562, at pp. 578 and 582 ; *Coaks v. Boswell* (1886) 11 App. Cas. 232, at p. 236 ; *Wasteney v. Wasteney* [1900] A.C. 446, at p. 451 ; *Seddon v. Noth Eastern Salt Co. Ltd* [1905] 1 Ch. 326, at p. 335 ; *Kelly v. Enderton* [1913] A.C. 191, at p. 194

that he has read the false reports which contained the alleged misrepresentation, he will fail in his action for rescission based on misrepresentation.¹⁷

If the representee knew already the truth of the representation, it will also have no legal effect. If the truth is known to the representee's agent who is acting within the scope of his authority, the representee will have no remedy even though it is not known to him.¹⁸ If the representee, who is aware of the misrepresentation, does not allow it to influence his judgment, for example, the cases where he regards the representation as unimportant one¹⁹, or if he relies upon his own judgment in the cases where he takes steps to discover the truth of the representation but fails to discover it, he will not obtain relief for misrepresentation. In *Attwood v. Small*²⁰, Lord Brougham L.C. said ;

"... moreover, the representations so made must have had the effect of deceiving the purchaser; and moreover, the purchaser must have trusted to these representation, and not to his own acumen, not to his own perspicacity, not to inquiries of his own."²¹

In the latter case where the representee relies on his own judgment, however, the above rule does not apply if the misrepresentation is fraudulent.²² Where the representee would have entered into the contract anyway even though he had known the truth, he

¹⁷*Re Northumberland and Durham District Banking Co. Ex parte Bigge*, (1859) 28 L.J. Ch. 50 ; *Horsfall v. Thomas*, (1862) 1 H. & C. 90, at p. 99 ; *Baty v. Keswick* (1901) 85 L.T. 18

¹⁸*Bawden v. London Assurance*, [1892] 2 Q.B. 534 ; *Strover v. Harrington* [1988] Ch. 390 ; cf. *Newsholme v. Road Transport Insurance Co. Ltd* [1929] 2 K.B. 356

¹⁹*Smith v. Chadwick* (1884) 9 App. Cas. 187

²⁰(1838) 6 Cl. & Fin. 232, at p. 448

²¹Also see, *Clarke v. MacKintosh* (1862) 4 Giff. 134 ; *A.-G. of N.S.W. v. Peters* (1924) 34 C.L.R. 146, at p. 152 ; *McInerny v. Lloyd's Bank Ltd* [1974] 1 Lloyd's Rep. 246, at p. 254

²²*S. Pearson & Son Ltd v. Dublin Corporation* [1907] A.C. 351 ; *Gordon v. Selico Co. Ltd* (1986) 278 Estates Gazette 53

will also have no remedy.²³ However, if the representee has the opportunity to discover the truth of the representation but does not take it, he may claim relief against fraudulent and negligent misrepresenter.²⁴ In *Redgrave v. Hurd*²⁵, this rule applied to an innocent misrepresenter. However, it would appear that this decision no longer applies under the present rule which distinguishes between negligent misrepresentations and wholly innocent misrepresentations. If the representer is wholly innocent, while the representee is careless in not taking the opportunity to discover the truth of representation although it is reasonable to expect him to take the opportunity, then it is unreasonable for the representee to claim relief for misrepresentation.²⁶

It happens sometimes that the plaintiff relies on the representation which was actually made by the representer to a third party, and the plaintiff is actually induced by the representation to contract with the representer. If the representer intended his representation to have this subsequent effect, he may be liable to the plaintiff if the statement was untrue. In addition, if the representation is made to a third party or to the general public in circumstances where the representer should, as a reasonable person, anticipate that it would be communicated to the plaintiff as one of the public, the representer may be liable to the plaintiff if the representation is untrue.²⁷

²³*Seddon v. North Eastern Salt Co.* [1905] 1 Ch. 326, at p. 335 ; *J.E.B. Fasteners Ltd v. Marks Bloom & Co.* [1983] 1 All E.R. 583

²⁴*Horsfall v. Thomas* (1862) 1 H. & C. 90 ; *Gordon v. Selico Co. Ltd* (1986) 278 Estates Gazette 53, at p. 61 ; *Strover v. Harrington* [1988] Ch. 390, at p. 410 ; *Smith v. Eric S. Bush* [1990] 1 A.C. 831 ; D. Allen, "Hedley Byrne Revalued", (1989) 105 L.Q.R. 511

²⁵(1881) 20 Ch.D. 1.

²⁶As to the analysis of the judgment of *Redgrave v. Hurd* in terms of the present rule, see, G. Treitel, *The Law of Contract*, (8th ed., 1991), Sweet & Maxwell/Stevens, at p. 304 (hereafter G. Treitel) ; D. Allen, *Misrepresentation*, (1988) Sweet & Maxwell, at pp. 17-18 (hereafter D. Allen)

²⁷*Swift v. Winterbotham* (1873) L.R. 8 Q.B. 244, at p. 253 ; *Pilmore v. Hood* (1883) 5 Bing. N.C. 97 ; *Peek v. Gurney* (1873) L.R. 6 H.L. 377, at p. 411 ; *Cross v. Lewis Hillman Ltd* [1970] Ch. 445, at p. 457 ; *Smith v. Eric S. Bush* [1990] 1 A.C. 831

The representee must prove, as a fact, that the representation in question has actually induced him to contract with the representor. However, this actual inducement, in certain circumstances in practice, can be inferred from the evidence for materiality, which is another alleged requirement to establish an actionable misrepresentation. This inference is not one of law, but one of fact.²⁸ The interpretation of the presumption of inducement is very important in practice, because, as a result of this presumption, the representor will have the burden of proof of non-inducement. If the presumption of inducement from materiality is widely accepted in the courts, the position of the representee will be formidable. This is particularly important in the case of insurance contract law.²⁹

6.2.1.5. MISCELLANIES

In order to establish an actionable misrepresentation, the representation in question need not have been the sole inducement to contract, as long as the misrepresentation can be shown to have been *an* effective inducement. In other words, the representee who relies on the representation in question can obtain relief for misrepresentation, even though there are also other factors which induced him to enter into the contract.³⁰ Mere proof that the representee relied on another factor in addition to the misrepresentation on which his action or defense is founded does not negative the fact of inducement.³¹ It is sufficient that the representation is one of the influential factors which are actively present to the representee's mind in relation to his judgment. The key point is not the

²⁸Smith v. Chadwick (1884) 9 App. Cas. 187, at p. 196

²⁹See, sub-chapter 6.3.1.5. of this thesis.

³⁰Mathias v. Yatts (1882) 46 L.T. 497, at p. 502 ; Edgington v. Fitzmaurice (1885) 29 Ch.D. 459, at pp. 480-485 ; Drincqbier v. Wood [1899] 1 Ch. 393, at pp. 404-405 ; Paul and Vincent Ltd v. O'Reilly (1913) 49 I.L.T. 89, at pp. 91-92 ; Horry v. Tate & Lyle Refineries Ltd [1982] 2 Lloyd's Rep. 417, at p. 422 ; cf. Lord Brougham stated, in Attwood v. Small (1838) 6 Cl. & Fin. 232, at pp. 447-448, that the representation must be made the very ground upon which this transaction took place, and must have given rise to the contract.

³¹Actionable Misrepresentation, at para. 116, footnote 4.

existence of the representation, but the actual influence of the representation along with the other factors. Therefore, where the representee does not really rely on the representation at all, even though the representation exists, because the other inducements are so influential, then relief for the misrepresentation in question will be denied.

Where a representation has more than one meaning, the representee should prove what he understood and relied on. In particular, where one meaning of it is true while the other is untrue, the representee should prove that he relied on the representation in the false or untrue meaning that is the meaning he took, in order to claim relief for misrepresentation.³²

For the purpose of determining the question of inducement whether the representation in question induced the representee to alter his position, all the circumstances such as the representee's professional knowledge or experience and the entirety of the representee's statements or the documents in which the representation in question is contained, must be considered.³³

6.2.2. MATERIALITY

6.2.2.1. GENERAL CONSIDERATION

It is commonly said that there is another element of an actionable misrepresentation along with the requirement of inducement. In general, misrepresentation must be

³²Smith v. Chadwick (1882) 20 Ch.D. 27, at p. 45 ; Capel & Co. v. Sim's Ships Composition Co. Ltd (1888) 58 L.T. 807, at pp. 808-809 ; Heilbut, Symons & Co. v. Buckleton [1913] A.C. 30

³³New Brunswick and Canada Railway and Land Co. v. Muggeridge (1860) 1 Drew & Sm. 363, at pp. 379-380 ; Bellairs v. Tucker (1884) 13 Q.B.D. 562, at p. 577 ; Smith v. Chadwick (1884) 9 App. Cas. 187, at p. 197 ; Arnison v. Smith (1888) 41 Ch.D. 348, at p. 369 ; Bloomenthal v. Ford [1897] A.C. 156, at p. 162 ; McConnel v. Wright [1903] 1 Ch. 546, at p. 551 ; R v. Bishirgian [1936] 1 All E.R. 586 ; Gross v. Lewis Hillman, Ltd [1969] 3 All E.R. 1476

material and it is not actionable unless it is material.³⁴ Likewise, for an actionable misrepresentation, it is necessary to establish separately the requirement of materiality apart from the requirement of inducement.³⁵ However, the concept of materiality has not been defined yet in a clear and authoritative manner. In defining materiality, there are two interpretations as to what should be the standard of judgment of materiality. One is the standard of judgment of a reasonable man. The other is the standard of judgment of a particular representee in question.

As discussed in the preceding section, materiality has an important evidentiary role. This evidentiary role is recognized even by those who do not regard the requirement of materiality as a separate requirement. The materiality of misrepresentation may be of great practical relevance in relation to the representee's proof that he is actually induced by the representation, and the important evidentiary role in materiality is mainly concerned with the question of presumption of inducement.

6.2.2.2. CONCEPT OF MATERIALITY

In general, if a misrepresentation only relates to an insignificant matter, then the misrepresentation will not be effective to claim relief for misrepresentation. There are two definitions as to the concept of materiality. The first one is this: the requirement means that the misrepresentation must be one which would affect the judgment of a reasonable man in deciding whether to contract with the representor or, if so, on what

³⁴*McDowell v. Fraser* (1779) 1 Dougl. 247, at p. 248 ; *Smith v. Chadwick* (1882) 20 Ch.D. 27, at pp. 44-45 ; (1884) 9 App. Cas. 187, at pp. 190 and 196 ; *Lonrho plc v. Fayed (No. 2)* [1992] 1 W.L.R. 1, at p. 6 ; G. Treitel, at pp. 301-302 ; *Actionable Misrepresentation*, at paras. 113 and 124-133 ; *Halsbury's Laws*, Vol. 31, at paras. 1066 and 1075-1078 ; D. Allen, at pp. 19-20

³⁵It is true that the separate requirement of materiality has been denied in *Museprime Properties Ltd v. Adhill Properties Ltd* [1990] 2 E.G.L.R. 1906. ; As to the skeptical view about the necessity of separate requirement of materiality see, Lord Goff of Chieveley and Gareth Jones, *The Law of Restitution* (4th ed., 1993), Sweet & Maxwell, at pp. 197-198. Also see, *Chitty on Contracts* (27th ed., 1994), Vol. 1, at para. 6-022. The full discussion as to this point is beyond the scope of this thesis, but some brief analysis will be made in the discussion of the concept of materiality.

terms; or one that would induce a reasonable man to enter into the contract without making such inquiries as he would otherwise make.³⁶ Therefore, materiality is decided by reference to the standard of judgment of a reasonable person. In other words, the requirement of materiality needs an objective criterion, while the question of inducement relies on the response of the particular representee, i.e., subjective standard. On the other hand, according to another definition as to the concept of materiality, a representation is material when its tendency, or its natural and probable result, is to induce the particular representee in question to enter into the contract or transaction which in fact he entered into, or to induce him to act on the faith of the representation in the manner in which he did in fact.³⁷ In other words, if a representation has a tendency to induce the particular representee, it is material. Therefore, this definition needs a standard of judgment of the particular representee.

The case law does not seem to provide an answer to the question of which view of the two definitions is more persuasive. In many cases, the distinction between the two has little meaning in practice. Where the particular representee in question has no special idiosyncrasies, and there is no special circumstance, it is difficult to see any substantial difference between the standard of the particular representee and that of the reasonable man. In this situation, the particular representee may be equated with a reasonable person.

However, to the knowledge of the representor, when the particular representee regards the particular representation which is not considered as important by the ordinary

³⁶*Traill v. Baring* (1864) 4 D.1. & S. 318, at p. 326 ; *Industrial Properties Ltd v. A.E.I. Ltd* [1977] Q.B. 580, at p. 597 ; *Highland Ins. Co. v. Continental Ins. Co.* [1987] 1 Lloyd's Rep. 109 ; *Pan Atlantic Ins. Co. Ltd v. Pine Top Ins. Co. Ltd* [1994] 3 W.L.R. 677 ; Marine Insurance Act 1906, Section 20(2). It is well recognized that general law is reflected in this provision. ; *Cheshire Fifoot & Furmston*, at p. 276 ; G. Treitel, at p. 301 ; D. Allen, at p. 19 ; *Chitty on Contracts*, Vol. 1, at para. 6-022

³⁷*Actionable Misrepresentation*, at para. 125 ; *Halsbury's Laws*, Vol. 31, at para. 1075

reasonable man under normal conditions as material, the difference may be seen in the two definitions. The examples of this situation are frequently found in the cases where the particular representation is concerned with the identity of the person who is the owner of property offered to the representee for sale, or of the intended purchaser from the representee of any property.³⁸

According to the second definition of materiality where the standard of judgment to apply is that of the particular representee, if the representor is aware of these special circumstances or idiosyncrasies, the representation as to these special characteristics will be material even though it will not influence a reasonable man under normal condition. For instance, in the general contract of sale, the identity of the intended purchaser is not considered as important by the vendor under normal circumstance. However, the identity may be crucial factor to the contract, if, for whatever reason, the particular vendor in question would have been unwilling to contract with a certain person. If the representor knows of this circumstance, a misrepresentation of the identity of the intended purchaser will be material.

At first glance, it seems that the first definition of materiality has a difficulty to explain this situation by reference to the standard of judgment of a reasonable man. In other words, it may be said that a reasonable man standard definition does not give consideration to the above situation. However, it would appear that the standard of a reasonable man impliedly exists in the above example. The materiality of the misrepresentation in the case where the representee has special characteristics and the representor is aware of them can be justified from the objective person's point of view, i.e., a reasonable man's point of view. In other words, a reasonable man can evaluate

³⁸*Bexwell v. Christie* (1776) 1 Cowp. 395 ; *Hill v. Gray* (1816) 1 Stark 434 ; *Fellowes v. Lord Gwydyr* (1829) 1 Russ. & M. 83 ; *Smith v. Wheatcroft* (1878) 9 Ch.D. 223 ; *Arkwright v. Newbold* (1880) 17 Ch.D. 301 ; *Whurr v. Devenish* (1904) 20 T.L.R. 385 ; *Lake v. Simmons* [1927] A.C. 487 ; Also see, *Actionable Misrepresentation*, at paras. 128-129

that this special situation will make the representation in question material. It would appear that the element of materiality still needs an object standard, and in fact the standard of a reasonable man still applies to the above cases where the representee's special idiosyncrasies are known to the representor. Therefore, it is wrong to say that the reasonable man standard definition (the first definition) takes no account of the cases where the representee's special characteristics are known to the representor.

According to the second definition - a representation is material when its tendency, or its natural and probable result, is to induce the representee to enter into the contract -, a tendency to induce means a tendency to induce the particular representee in the particular circumstances of the individual case.³⁹ This definition seems to be more related with the question of inducement. The second definition inevitably leads to a view that the representation under special circumstances known to the representor is material as between the parties, saying that the point is whether or not, but for the representation, the representee would have ever entered into the contract.⁴⁰ It is not easy to see any substantial difference between 'inducement' and 'materiality between the parties'.

The expressions of 'tendency, or natural and probable result' should be proved first by an objective criterion because the words 'tendency' or 'probability' are often based on the objective test. These expressions can be also linked with the words 'capable of inducing'. This expression of 'capable of inducing' also needs an objective test to justify it, although the question of inducement itself needs an subjective test. An objective test usually means an reasonable man standard. Therefore, a reasonable man standard impliedly exists in the second definition and this reasonable man standard should be used in determining "the representation's tendency or natural and probable result of the

³⁹*Actionable Misrepresentation*, at paras. 125 and 127

⁴⁰*Sibbald v. Hill* (1814) 2 Dow. 263, at p. 267 ; *Gordon v. Street* [1899] 2 Q.B. 641, at pp. 645-646 ; *Actionable Misrepresentation*, at para. 129 ; *Halsbury's Laws*, at para. 1077

misrepresentation”, before considering the actual inducement to the particular representee in question.

In addition, according to the second definition, the representation is material if its tendency or probable or natural effect is to induce the particular representee, while the requirement of actual inducement can be established if the representation's actual effect is to induce the particular representee. However, these two separate requirements can be mixed and confused if a particular representee is the only criterion to determine them. Without the objective standard, there is not much difference between the elements of inducement and materiality. In any ordinary case, if the representee regarded a material representation as immaterial, it cannot influence the nature of materiality of the representation itself, although his personal view of immateriality would be reflected in determining the nature of inducement. Consequently, the requirement of materiality needs an objective standard. In *Smith v. Chadwick*⁴¹, Jessel M.R. referred to the concept of materiality in the Court of Appeal ;

“... of such a nature as would induce a person to enter into the contract, or would tend to induce him to do so.”⁴²

Again, Lord Blackburn expressed his view on the concept of materiality using similar language in the House of Lords ;

“... of such a nature as would be likely to induce a person to enter into a contract...”⁴³

These two statements seem to be related with the first definition, because both statements chose “a person”, not “a particular representee” as a necessary standard in determining materiality.

⁴¹(1882) 20 Ch.D. 27

⁴²Ibid., at p. 44

⁴³(1884) 9 App. Cas. 187, at p. 196

A clear distinction should be recognized between the requirement of materiality and that of inducement. It is submitted that the element of materiality requires an objective test, whereas the question whether or not the particular representee in question is actually induced by the misrepresentation needs a subjective standard, i.e., the actual effect on the particular representee. The first definition by reference to the reasonable man standard seems to be more persuasive and effective to distinguish two separate requirements - materiality and inducement -.

6.2.2.3. POSITION OF REQUIREMENT OF MATERIALITY

Inducement and materiality are wholly separate and distinct concepts. In other words, materiality is a requirement which is not dependent on the element of inducement. It is true that there are cases where actual inducement may be inferred as a fact from manifest materiality. However, it does not influence the existence of the two quite separate requirements. Both issues are separate and it is necessary to prove separately both of them as a fact.⁴⁴

The examples of the requirement of materiality are largely to be found in insurance contract law. Based on this, there is skeptical view of the existence of the separate requirement of materiality, saying that a requirement of materiality is a necessary part of a rule requiring disclosure, whereas it is not a necessary part of a rule affording relief for active misrepresentation.⁴⁵ In *Nicholas v. Thompson*⁴⁶, McArthur J. maintained that

⁴⁴*Flinn v. Headlam* (1829) 9 B. & C. 693 ; *Clapham v. Shillito* (1844) 7 Beav. 146 ; *Re Universal Non-Tariff Fire Insurance Co, Forbes & Co's Claim* (1875) L.R. 19 Eq. 485, at pp. 493, 434 and 496 ; *Capel & Co. v. Sim's Ships Compositions Co. Ltd* (1888) 58 L.T. 807, at pp. 809-810 ; *Andrews v. Mockford* [1896] 1 Q.B. 372 ; *Whurr v. Devenish* (1904) 20 T.L.R. 385

⁴⁵*Chitty on Contracts* (27th ed., 1994), Vol. 1., Sweet & Maxwell, at para. 6-022. Also see, Lord Goff of Chieveley and Gareth Jones, *The Law of Restitution* (4th ed., 1993), Sweet & Maxwell, at pp. 197-198.

⁴⁶[1924] V.L.R. 554

materiality was not an independent and separate requirement for actionable misrepresentation, saying ;

"... it [the materiality of the statement] does not appear to me to be, strictly speaking, an essential element of the cause of action... it would be unnecessary that there should be a further finding that the statement was material.... The fact that the statement was made for the purpose of inducing would... show that the statement was material - at all events, in the opinion of the representor; and from the fact that the representee was thereby induced it would necessarily follow. I think, that in the mind of the representee the statement was material. So that if both these facts were proved, it would show that, as between the parties, at all events, the statement was material."⁴⁷

However, Spencer Bower expressed a skeptical view in the following terms ;

"If intention to induce, and resultant alteration in position, are proved, the court *may* without more, in the circumstances of a particular case, infer materiality, and will do so in many cases; but it will not *necessarily* do so."⁴⁸

The traditional view has recognized the requirement of materiality as a necessary element and this view has been supported by the courts.⁴⁹ In addition, the element of materiality has become a main issue in some cases which are not contracts of insurance, for instance, a contract for a loan of money and an auction sale of a property.⁵⁰ In addition, in *Smith v. Chadwick*⁵¹, Lord Blackburn admitted the separate requirement of materiality ;

"I think that if it is proved that the defendants with a view to induce the plaintiff to enter into a contract made a statement to the plaintiff of such a nature as would be likely to induce a person to enter into a contract; and it is proved that the plaintiff did enter into the contract, it is a fair inference of fact that he was induced to do so by the statement."⁵²

⁴⁷*Ibid.*, at p. 577 ; Also see, *Museprime Properties Ltd v. Adhill Properties Ltd* [1990] 2 E.G.L.R. 196

⁴⁸*Actionable Misrepresentation*, at para. 128, footnote 2

⁴⁹*Jennings v. Broughton* (1854) 5 De G.M. & G. 126, at p. 130 ; *Smith v. Chadwick* (1882) 20 Ch.D. 27, at p. 44, (1884) 9 App. Cas. 187, at pp. 190 and 196 ; *Smith v. Land and House Property Corporation* (1884) 28 Ch.D. 7, at p. 16 ; *Andrews v. Mockford* [1896] 1 Q.B. 372 ; Also see, M.I.A. 1906 s.20(2). It has been said that this provision represents the general law.

⁵⁰*Gordon v. Street* [1899] 2 Q.B. 641 ; *Whurr v. Devenish* (1904) 20 T.L.R. 385

⁵¹(1884) 9 App. Cas. 187

⁵²*Ibid.*, at p. 196

According to this view, the separate and independent requirement of materiality is needed in relation to the inference of actual inducement. Also, Lord Selbourne L.C. in the same case expressed the same view, requiring two elements - the representation must be material, and it must have induced the representee's conduct ;

"[The representee] must establish that the fraud was an inducing cause to the contract; for which purpose it must be material, and it must have produced in his mind an erroneous belief, influencing his conduct."⁵³

The important evidentiary role of materiality could be another reason for supporting the necessity of the separate and distinct requirement of materiality, because if the representation is not material by reference to a reasonable man standard, the representee may have substantial difficulty in satisfying the court that he was in fact influenced and induced by the representation in question. A representation which was not material by definition would necessarily relate to a matter of trivial importance so that its untruth would cause but little loss to the representee. If the representor has made such a representation in good faith, it is difficult to see why a representee in question should be entitled to any relief when, by definition, the representation would not have influenced a reasonable person. It is hard to see a justification of accepting a claim to rescind for such a misrepresentation because it is unmeritorious.⁵⁴ In conclusion, the requirement of materiality should be distinct from that of inducement. The materiality of representation depends on the significance which a reasonable man would have attached to the representation in question, whereas the requirement of inducement is decided by the representee's actual state of mind.

6.2.3. RELATIONSHIP OF TWO REQUIREMENTS

⁵³Ibid., at p. 190

⁵⁴*Industrial Properties Ltd v. A.E.I. Ltd* [1977] Q.B. 580 ; G. Treitel, at p. 302 ; D. Allen, at p. 19 ; cf. *Museprime Properties Ltd v. Adhill Properties Ltd* [1990] 2 E.G.L.R. 196. As to the analysis of the judgment of this case, see G. Treitel, at p. 302

6.2.3.1. GENERAL CONSIDERATION

The requirements of materiality and inducement which are needed for actionable misrepresentation are separate elements, and *prima facie* questions of fact.⁵⁵ However, despite the distinct and separate nature, each requirement may be inferred from other circumstances of the case. In other words, even though two questions are separately important, these two questions in many cases are closely correlated in practice, because evidence for one question is likely to be used for the other. In theory, both in misrepresentation and in non-disclosure, two questions are separately important, but in practice, the question of inducement has been more important in a misrepresentation case, whereas in non-disclosure case, the issue of materiality has been more crucial. There are few misrepresentation and non-disclosure cases in which two issues were dealt with equally.

6.2.3.2. INFERENCE OF MATERIALITY

In some cases, the element of materiality can be inferred from the proof of actual inducement, i.e., the evidence which proves the requirement of inducement may lead to an legitimate inference of materiality. In other words, if intention to induce and resultant alteration in position are proved by the representee, the court may in the particular circumstances of the cases, without more, infer materiality.

This inference of materiality is apparent in the case where the actual representee has no special idiosyncrasies and there is no special circumstance to be taken into account. In this case, if intention to induce actual inducement and actual resultant inducement are proved by the representee, a contention that the representation in question was not

⁵⁵*Flinn v. Headlam* (1829) 9 B. & C. 693 ; *Clapham v. Shillito* (1844) 7 Beav. 146 ; *Cazenove v. British Equitable Assurance Co. Ltd* (1860) 29 L.J.C.P. 160 ; *Re Universal Non-Tariff Fire Insurance Co. Forbes & Co's Claim* (1875) L.R. 19 Eq. 485, at pp. 493, 494 and 496 ; *Arnison v. Smith* (1889) 41 Ch.D. 348, at p. 374 ; *Andrews v. Mockford* [1896] 1 Q.B. 372, at p. 374 ; *Bloomenthal v. Ford* [1897] A.C. 156, at p. 162 ; *Whurr v. Devenish* (1904) 20 T.L.R. 385 ; M.I.A. 1906 s.20(7)

material can be hardly accepted, because the actual representee under this circumstance could be equated with a reasonable man. Although inference of materiality is available, however, the two requirements - materiality and inducement - should be regarded as distinct concepts and as a matter of fact. In *Nicholas v. Thompson*⁵⁶, materiality was inferred from the proof of actual inducement. However, the judgment of this case has been subject of criticism, because Cussen A.C.1. and McArthur 1. inferred materiality as a matter of law from inducement and they held that materiality was not a separate requirement for actionable misrepresentation.⁵⁷ Inducement and materiality are separate requirements and issues of fact. Neither can be inferred as a matter of law.

6.2.3.3. INFERENCE OF INDUCEMENT

It is submitted that the element of materiality plays an important evidentiary role in relation to the requirement of inducement. This evidentiary role of materiality has been recognized even by those who do not regard the element of materiality as a separate and independent requirement. If the judge decides that the misrepresented fact is material, in practice, it is likely to be used to decide that the representee was affected, unless there is some evidence to show that the representee was not induced. In other words, the fact that the representation in question was material provides some valuable evidence in support of the representee's claim that he was actually induced to contract with the representor by the representation. In certain cases, actual inducement may be inferred as a fact from palpable and obvious materiality with little or, in some extreme cases, with no further evidence.

⁵⁶[1924] V.L.R. 554

⁵⁷[1924] V.L.R. 554, at pp. 566 and 577. Cussen A.C.1. said (at p. 566) that "Supposing defendant had admitted that the representation was made in order to induce, and that it did induce, could he insist that plaintiffs were bound to prove, in addition, something not expressly alleged - namely, that it was material? I do not think so." McArthur 1's passage (at p. 577) is cited in the part of position of materiality in the preceeding section.

In general, if it is established that misrepresentation is untrue and material, the question of whether the materiality establishes the inducement depends on what evidence is given by the representee. If the representee gives evidence that he would have acted differently, had the fact been disclosed, the court will decide the question of inducement based on this evidence. In this situation, the lawyers for the representor will try to establish by cross-examination that there was no inducement. Likewise, if there is evidence given by the representee, there will be little room for inference (presumption) of inducement. On the other hands, if the representee does not give evidence in relation to the issue of inducement, then the question of the presumption of inducement can be relied on by the representee. This is an important question in practice.⁵⁸

Where there is no particular representee's special idiosyncrasies to be taken into account, the courts are likely to equate the particular representee with a reasonable person. In this situation, if the representation would have induced a reasonable person to enter into the contract with the representor, the courts will often infer as a fact that the particular representee in question was so induced by the representation. There is no need for the particular representee in question to adduce any other evidence to establish inducement under this circumstance. For example, Lord Blackburn said in *Smith v. Chadwick*⁵⁹ ;

"I think that if it is proved that the defendants with a view to induce the plaintiff to enter into a contract made a statement to the plaintiff of such a nature as would be likely to induce a person to enter into a contract, and it is proved that the plaintiff did enter into the contract, it is a fair inference of fact that he was induced to do so by the statement."⁶⁰

⁵⁸For the full discussion of presumption of inducement, see sub-chapter 6.3.1.5 of this chapter.

⁵⁹(1884) 9 App. Cas. 187, at p. 196

⁶⁰Also see, *Clapham v. Shillito* (1844) 7 Beav. 146, at pp. 150-152 ; *Smith v. Chadwick* (1882) 20 Ch.D. 27, at p. 44. ; *Mathias v. Yetts* (1882) 46 L.T. 497, at p. 502 ; *Smith v. Land and House Property Co.* (1884) 28 Ch.D. 7, at p. 16 ; *Hughes v. Twisden* (1886) 55 L.J.Ch. 481, at p. 484 ; *Arnison v. Smith* (1889) 41 Ch.D. 348, at p. 369 ; *Moss & Co. Ltd v. Swansea Corpn* (1910) 74 J.P. 351

Of course, if the representation would not have induced a reasonable man, the above inference cannot be made. In this situation, some extra evidence is needed. The burden to prove how the particular representee was induced by the representation when a reasonable man would not have been so induced by it lies on the particular representee. Where the particular representee in question has special idiosyncrasies, it does not seem that there is room for the application of the inference of inducement. In this situation, the representee may prove how he was induced by the representation by showing the existence of those idiosyncrasies and the representor's knowledge of them.

Inducement may be inferred as a fact from obvious materiality, and cannot be presumed as a matter of law from proved materiality. It means that, even in the cases where inference of inducement is available, this inference may be rebutted by counter-evidence.⁶¹ In other words, the representor is allowed to prove that there is no actual inducement of the representee in the case where the inference of inducement is available.

For instance, Lord Blackburn said in Smith v. Chadwick⁶² ;

"And whenever that is a matter of doubt I think the tribunal which has to decide the fact should remember that ... the plaintiff [representee] can be called as a witness on his own behalf, and that if he is not so called, or being so called does not swear that he was induced, it adds much weight to the doubts whether the inference was a true one. I do not say it is conclusive."

This interpretation as to the inference of inducement was not the position of Jessel M.R. in Redgrave v. Hurd⁶³ saying that ;

"... when a person makes a material representation to another to induce him to enter into a contract, and the other enters into that contract, it is not sufficient to say that the party to whom the representation is made does not prove that he entered into the contract, relying upon the representation. If it is a material representation calculated to induce him to enter into the contract, it is an inference of law that he was induced by the representation to enter into it..."

⁶¹Smith v. Chadwick (1882) 20 Ch.D. 27, at p. 44, (1884) 9 App. Cas. 187, at p. 196 ; Hughes v. Twisden (1886) 55 L.J.Ch. 481, at p. 484 ; Arnison v. Smith (1889) 41 Ch.D. 348, at p. 369

⁶²(1884) 9 App. Cas. 187, at pp. 196-197

⁶³(1881) 20 Ch.D. 1, at p. 21

This passage clearly shows that the court is at liberty to infer the particular representee's actual inducement as a matter of law from proved materiality without any evidence whatsoever. However, his view, which was based on the law of evidence as it existed until 1851, has been rejected in a series of cases and textbooks. For example, Bowen L.J. in Smith v. Land and House Property Corporation⁶⁴ said ;

"I cannot quite agree with the remark of the late Master of the Rolls in Redgrave v. Hurd ... and I think that probably his Lordship hardly intended to go so far as that, though there may be strong reason for drawing such an inference as an inference of fact."

Also, Lord Blackburn said in Smith v. Chadwick⁶⁵ ;

"In Redgrave v. Hurd, the late Master of the Rolls is reported to have said it was an inference of law. If he really meant this he retracts it in his observations in the present case. I think it not possible to maintain that it is an inference of law ... I quite agree that being a fair inference of fact it forms evidence proper to be left to a jury as proof that he was so induced."⁶⁶

Likewise, the inference of inducement is an inference of fact and the representor should be permitted to adduce other evidence to rebut the inference and to show that the representee in question was not so induced by the representation. The representor may rebut the inference of inducement by showing, for instance, that the representation did not come to the representee's notice, or that the representee knew the truth of the representation, or that the representee did not allow the representation to affect his judgment. In J.E.B. Fastners Ltd v. Marks Bloom & Co.⁶⁷, even though the misrepresentation in question was apparently material, the representee's claim for

⁶⁴(1884) 28 Ch.D. 7, at p. 16

⁶⁵(1884) 9 App. Cas. 187, at p. 196

⁶⁶Also see, Mathias v. Yetts (1882) 46 L.T. 497, at p. 502 ; Hughes v. Twisden (1886) 55 L.J.Ch. 481, at p. 484 ; Arnison v. Smith (1889) 41 Ch.D. 348, at p. 369 ; Actionable Misrepresentation, at para. 133 ; G. Treitel, at pp. 306-307 ; D. Allen, at p. 20 ; Halsbury's Laws, at para. 1067

⁶⁷[1983] 1 All E.R. 583

damages for misrepresentation was dismissed because it was proved that the representee had not relied at all on the representation and their object to enter into the contract had nothing to do with the representation in question.

In conclusion, the inference of inducement is an inference of fact. It means that the fact that the representation is one that would affect the judgment of a reasonable man does not necessarily mean that it persuades the particular representee to contract with the representor.

6.3. INSURANCE CONTRACT LAW

6.3.1. REQUIREMENT OF ACTUAL INDUCEMENT

6.3.1.1. GENERAL CONSIDERATION

According to the strict interpretation and application of the "prudent insurer test", the state of mind of the actual insurer who is trying to avoid the policy is irrelevant for the purpose of determining materiality. In other words, as a result of adopting the hypothetical prudent insurer test as a yardstick of the test of materiality, it is irrelevant whether the actual insurer would have imprudently accepted the risk on the same terms even if he had been aware of the true position in determining materiality. However, one question as regarding the state of the mind of the actual insurer remains. If an insured in a particular case fails to disclose a fact which, objectively evaluated through expert evidence, would influence the judgment of a prudent underwriter in fixing the premium or determining whether to take the risk, is it still justifiable for the actual insurer who would not have been so influenced by the non-disclosure to avoid the policy?

It is clear that the view that the test of materiality should be based solely on the decision of the actual insurer has received little support. However, there has existed a view that the response of the actual insurer should be considered as one of the double-check methods or as an independent requirement before he could avoid a contract for non-

disclosure of a material fact. The response of the actual insurer is mainly concerned with the question of the requirement of the inducement of the actual insurer by non-disclosure or misrepresentation in making of the insurance contract, and is closely related to the issue of the protection of the insured.

In fact, some difficulties to accept this additional requirement of inducement exist. According to ss. 18 and 20 of the M.I.A. 1906, there is no mention of a causal connection between non-disclosure or misrepresentation of a material fact and the making of the contract of insurance. In other words, any requirement that the actual insurer must additionally prove that he was actually induced by the non-disclosure or misrepresentation of a material fact to enter into the contract cannot be found in the wordings in the relevant sections. Henry Brooke argued in his article that the omission of any reference to the actual inducement from the M.I.A. 1906 was a deliberate one, saying that ;

"When he came to draft the Marine Insurance Act 1906, the draftsman did not have to include a requirement that it must be shown that an effect of a material misrepresentation or non-disclosure was to induce the actual insurer to enter the insurance contract from which he sought relief because this requirement had been abolished in *Ionides v. Pender*. The draftsman was therefore concerned only with the effect of the non-disclosure or misrepresentation on the mind of a hypothetical prudent insurer."⁶⁸

It is also true that there is little clear authority by the courts as regarding this additional requirement of inducement prior to the enactment of the M.I.A. 1906. The difficulty to accept this additional requirement of actual inducement seems to be also caused by the tendency to discuss inducement as if it were merely a component of materiality.⁶⁹ In *Zurich General Accident and Liability Insurance Co. Ltd v. Morrison*⁷⁰, Mackinnon L.J. denied the necessity of this additional requirement ;

⁶⁸"Materiality in insurance contracts" [1985] L.M.C.L.Q. 437, at p. 444

⁶⁹D. Kelly & M. Ball, *Principles of Insurance Law in Australia and New Zealand*, (1991), Sydney, at para. 3.177 (hereafter Kelly & Ball)

⁷⁰[1942] 2 K.B. 53

"What is material is that which would influence the mind of a prudent insurer in deciding whether to accept the risk or fix the premium, and if this be proved it is not necessary further to prove that the mind of the actual insurer was so affected."⁷¹

However, the view that it is unfair for the underwriter who has paid no attention to the matters not disclosed and has suffered no injustice thereby to escape liability on the ground of the non-disclosure of a material fact based on the prudent insurer test, cannot be easily ignored, although the above reasons look formidable. Should the inducement of the actual insurer in the making of the contract by non-disclosure of a material fact be required to avoid liability? If so, how and in what way should s. 18 of the M.I.A. 1906, which does not explicitly require it, be interpreted? This has been a long-standing argument in insurance contract law. To deal with this question, it seems appropriate to trace back the background of the enactment of s. 18., which was strongly influenced by the decision of *Ionides v. Pender*.⁷²

6.3.1.2. HISTORY OF INTERPRETATION OF THIS REQUIREMENT

Until the middle of the 19th century, inducement of the actual insurer was required and had to be proved in the test of materiality as a matter of common law in the wake of the ordinary application of equitable principles.⁷³ John Duer made it clear that inducement was required, saying that non-disclosure was only material if it not only induced the particular insurer to enter the contract, but also actually affected the risk to be insured against.⁷⁴ Also, Willard Phillips supported the view of the requirement of inducement of actual insurer, saying ;

⁷¹Ibid., at p. 60 ; Also see, *Mayne Nickless Ltd v. Pegler* [1974] 1 N.S.W.L.R. 228, at p. 239

⁷²(1874) L.R. 9 Q.B. 531

⁷³*Rickards v. Murdock* (1830) 10 B. & C. 527, at p. 540 ; *Rivaz v. Gerussi Bros & Co.* (1880) 6 Q.B.D. 222, at p. 229

⁷⁴*The Law and Practice of Marine Insurance* (1846) Vol. II, at pp. 388-390 and 680-682

"Concealment in insurance is where, in reference to a negotiation therefore, one party suppresses, or neglects to communicate to the other, a material fact, which, if communicated, would tend directly to prevent the other from entering into the contract, or to induce him to demand terms more favorable to himself..."⁷⁵

Joseph Arnould expressed the same view in the early edition of his textbook ;

"Concealment, in the law of insurance, is the suppression of a material fact within the knowledge of the assured which the underwriter has not the means of knowing, or is not presumed to know; by a material fact is meant, one which, if communicated to the underwriter, would induce him either to refuse the insurance altogether, or not to effect it except at a higher premium."⁷⁶

This view was made before *Ionides v. Pender*.⁷⁷ However, his successive editions continued to support the view of the requirement for inducement of the actual insurer. For example, in the 6th edition which was published after *Ionides v. Pender*, materiality was defined as follows;

"A material fact in this connection is one which, if communicated to the other of the parties, would induce him either to refrain altogether from the contract, or not to enter into it on the same terms."⁷⁸

Also, in the 8th edition, inducement was again required to prove in order to avoid the policy. The editors pointed out that on a literal construction of s. 20 of the M.I.A. 1906 inducement was not required, but the editors disagreed with it, saying that ;

"Such a construction involves an anomalous state of the law. For it is clear that ... even a fraudulent misrepresentation gives no right to rescind a contract, when it has not influenced the party to whom it was made."⁷⁹

In the current edition, the requirement of inducement of the actual insurer was clearly supported ;

⁷⁵*A Treatise on the Law of Insurance* (5th ed.) at section 531. This test was cited by Brett L.J. in *Rivaz v. Gerussi Brothers & Co.* (1880) 6 Q.B.D. 222, at p. 229

⁷⁶*A Treatise on the Law of Marine Insurance and Average* (2nd ed., 1857) Vol. I, at p. 584 ; Also see, the First edition, (1848) Vol. 1, at p. 536

⁷⁷(1874) L.R. 9 Q.B. 531

⁷⁸(1887) Vol. I., at p. 548

⁷⁹The 8th edition (1909) at pp. 694-695 ; Also see, The 7th edition (1901), at p. 641

"Even though a circumstance may be material, in the sense that it would influence a prudent insurer, if the underwriter concerned would not have been influenced by that circumstance if disclosed, he cannot rely on the non-disclosure to avoid the policy."⁸⁰

This view was expressly accepted by Chalmers and Owen ;

"The contract is often said to be rendered void by concealment or misrepresentation, but it is clear that it is only voidable at the option of the party prejudiced..."⁸¹

Again, this view was approved in *Halsbury's Laws in England* ;

"It is submitted that it is rightly argued in *Arnould on Marine Insurance*, 8th ed. (1909), vol. I, section 536, that as a fraudulent representation will not avoid the contract if it did not influence the mind of the contracting party, this must a fortiori be true of an innocent misrepresentation."⁸²

Likewise, as a matter of common law, inducement of the actual insurer was required and had to be proved not only in the 19th century but also after the enactment of the M.I.A. 1906. After the passing of the Act, some cases referred to this requirement of actual inducement in misrepresentation and non-disclosure. For example, Isaacs C.J. in *Western Australian Insurance Co. Ltd v. Dayton*⁸³ said that a non-disclosure would not be material if disclosure of the fact in question would have been irrelevant to the particular insurer in question, saying ;

"The test of materiality is whether in view of "all the circumstances at the time", which include, of course, the full circumstances of the fact undisclosed, that fact would have influenced the company as a prudent insurer in fixing the premium or in determining to accept the risk. But it must not be forgotten that 'the circumstances' include the knowledge, the practice and the proved conduct of the insurer. If... it were the known practice of a company to disregard a certain class of facts, the non-disclosure of such a fact would not prima facie qua that company be material, however it might be with regard to another company."

⁸⁰See, the 16th edition (1981) Vol. II, at p. 489

⁸¹*A Digest of the Law relating to Marine Insurance* (1st ed.) at p. 22 ; The 2nd edition, at p. 24

⁸²(1st ed., 1911) Vol. 17, at p. 414

⁸³(1924) 35 C.L.R. 355, at pp. 379-380

More recently, Kerr J. in *Berger v. Pollock*⁸⁴, relying particularly on Scrutton L.J.'s judgment in *Visscherij Maatschappij Nieuw Onderneming v. Scottish Metropolitan Assurance Co.*⁸⁵ emphasized the role of the actual insurer. This case dealt with so-called subjective immateriality, i.e., the facts which would influence the prudent insurer but not the actual insurer. He had to consider whether an insurer could avoid a policy for misrepresentation or non-disclosure without actually giving evidence to say he himself would have been affected by it. Kerr J. said ;

"It seems to me, as a matter of principle, that the court's task in deciding whether or not the defendant insurer can avoid the policy for non-disclosure must be to determine as a question of fact whether, by applying the standard of the judgment of a prudent insurer, the insurer in question would have been influenced in fixing the premium or determining whether to take the risk if he had been informed of the undisclosed circumstances before entering into the contract. Otherwise one could in theory reach the absurd position where the court might be satisfied that the insurer in question would in fact not have been so influenced but that other prudent insurers would have been. It would then be a very odd result if the defendant insurer could nevertheless avoid the policy ... the underwriter concerned should have been called in the present case, and this should be the practice in all doubtful cases even if an independent underwriter or broker is called as well."⁸⁶

However, the above interpretation was totally reversed by the Court of Appeal in the *Container Transport International Inc. v. Oceanus Mutual Underwriting Association (Bermuda) Ltd*⁸⁷. The Court of Appeal made it clear that the prudent insurer test is the sole test, rejecting the particular insurer test as one part of the two-limb test, ruling that an insurer was entitled to avoid the policy for failure to disclose any circumstance which a prudent insurer would take into account in reaching his decision as to whether or not to take the risk and, if so, on what terms including the premium, regardless of whether the particular insurer would have taken it into account. Kerr L.J., who was influenced by

⁸⁴[1973] 2 Lloyd's Rep. 442

⁸⁵(1921) 27 Com. Cas. 198

⁸⁶[1973] 2 Lloyd's Rep. 442, at p. 463. Even though Kerr J. accepted the requirement of actual inducement of the insurer, he seemed to confuse the actual insurer with the prudent insurer to some extent. ; Also see, *Visscher Enterprises Pty Ltd v. Southern Pacific Insurance Co. Ltd* [1981] Qd R 561

⁸⁷[1984] 1 Lloyd's Rep. 476

Zurich General Accident and Liability Insurance Co. Ltd v. Morrison⁸⁸, overruled his earlier decision and held that it was not necessary to prove that the mind of the actual insurer had been affected, saying ;

"This section [s. 18(2) of the M.I.A. 1906] is directed to what would have been the impact of the disclosure on the judgment of the risk formed by a hypothetical prudent insurer in the ordinary course of business... He is in a hypothetical position ... I was wrong in my reasoning in *Berger v. Pollock*..."⁸⁹

This view was confirmed in the Court of Appeal in the Pan Atlantic case⁹⁰ which had a great opportunity to analyze the effect of the Court of Appeal's decision in the C.T.I. case on this issue. It held that it was bound by the decision in the Court of Appeal in the C.T.I. case as to the irrelevance of the state of mind of the actual insurer when faced with a misleading proposal, saying that ;

"The rule laid down in *C.T.I. v. Oceanus* is that the only person to be considered is the prudent insurer. The views of the actual underwriter are irrelevant as to materiality... So far the effect of *C.T.I. v. Oceanus* is not in doubt."⁹¹

Potter J. in *St. Paul Fire & Marine Insurance Co. Ltd v. McConnell Dowell Constructors Ltd*⁹² also supported this decision. In this case, although he summarized the evidence from the actual underwriters, he did not make a finding as to whether the underwriters had been actually induced by the non-disclosure or misrepresentation to enter into the contract. Likewise, the requirement of actual inducement of the insurer by

⁸⁸[1942] 2 K.B. 53

⁸⁹[1984] 1 Lloyd's Rep. 476, at pp. 492 and 495. However, Kerr L.J. said that his former views in *Berger v. Pollock* might have some force outside the context of commercial insurance. Ibid., at p. 495 ; Although Parker L.J. referred to Willard Phillips's interpretation of materiality in insurance contracts which implied the requirement of inducement, he agreed with Kerr L.J. Ibid., at p. 508 ; Also see, *Mayne Nickless Ltd v. Pegler* [1974] 1 N.S.W.L.R. 228 ; *Avon House Ltd v. Cornhill Insurance Co. Ltd* (1980) 1 A.N.Z. Ins. Cas. para 60-429, 77, 228

⁹⁰[1993] 1 Lloyd's Rep. 496

⁹¹Ibid., at p. 504

⁹²[1993] 2 Lloyd's Rep. 503

the non-disclosure of a material fact in the making of the insurance contract had been rejected in a series of recent cases.

6.3.1.3. HOUSE OF LORDS IN PAN ATLANTIC CASE

This eagerly-awaited decision made it clear that the insurer had to show that he had actually been induced by the non-disclosure to enter into the policy on the relevant terms in order to avoid a contract for non-disclosure of a material circumstance, reversing the rule in the Court of Appeal in the C.T.I. case that the insurer who sought to avoid the policy was under no obligation to prove that he was induced to enter into the contract. Now, the insurer must satisfy two tests before they can successfully avoid liability on a policy based on misrepresentation or non-disclosure. The first one is that the non-disclosure or misrepresentation must be material according to the objective prudent insurer test. The second one is that non-disclosure must have actually induced the actual insurer when making the contract. Despite the absence of any express requirement of actual inducement in the relevant sections in the M.I.A. 1906, the House of Lords unhesitatingly accepted this requirement of actual inducement because they felt that logic and justice required this requirement. This is the most significant result of the judgment. Lord Mustill, after the detailed analyses on the previous authorities said ;

"... I conclude that there is to be implied in the Act of 1906 a qualification that a material misrepresentation will not entitle the underwriter to avoid the policy unless the misrepresentation induced the making of the contract, using "induced" in the sense in which it is used in the general law of contract."⁹³

His reasoning is based on the fact that under the general law on misrepresentation, it was necessary for the representee to show actual inducement. As far as the issue of misrepresentation is concerned, this requirement of actual inducement merely re-aligns

⁹³[1994] 3 W.L.R. 677, at p. 712. He also said "even if the effect of *Ionides v. Pender* had been to make the influence on the hypothetical underwriter the benchmark of materiality, I am unable to see why this should not have left behind such requirement of actual causation as had previously formed part of the common law." Ibid., at p. 711 ; Also see, Lord Goff's judgment, Ibid., at pp. 681-682 ; Lord Lloyd of Berwick's decision, Ibid., at p. 732

insurance contracts with general contracts. This is consistent with the M.I.A. 1906, which preserved 'the rules of the common law including the law merchant, save in so far as they are inconsistent with the express provisions of this Act...'94

However, he also showed a clear view that this conclusion should be applied to the case of non-disclosure. Considering the fact that the general law of contracts is not of the utmost good faith and consequently there is no general duty of disclosure, adding the requirement of actual inducement to the case of wrongful non-disclosure has the appearance of something new. In fact, it is difficult, unlike a misrepresented fact, to appreciate how something which the insurer does not know the existence of can actually induce him to enter into making a contract. In addition, the fact that two factors - intention to induce and the result of alteration of position - constitute inducement, might be incompatible with a non-disclosure, considering the current prevailing interpretation that it is not necessary for an insurer to show that a failure to disclose was intentional in order to succeed with a non-disclosure argument.

However, the separation of misrepresentation and non-disclosure is usually impossible in practice because of the close connection between them. Misrepresentation and non-disclosure commonly appear in tandem in pleadings in practice. In other words, the line between non-disclosure and misrepresentation is often imperceptible. It would be intolerable and anomalous if this new requirement of actual inducement applies only to misrepresentation. Lord Mustill stated that this principle should be applied to non-disclosure by saying ;

"If the Act, which did not set out to be a complete codification of existing law, will yield to qualification in one case surely it must in common sense do so in the other. If this requires the making of new law, so be it. There is no subversion here of established precedent."95

94S. 91(2) of the M.I.A. 1906

95[1994] 3 W.L.R. 677, at p. 712 ; Also see, Ibid., at pp. 681-682 (Lord Goff) ; As to some doubtful opinion on the direct application of this principle to non-disclosure, see, N. Hird, "Rationality in the House of Lords?" [1995] 1 B.L. 194, at pp. 196-197

As regarding the degree of inducement, the analysis of this issue in the general law of contract should be the starting point. In case of fraud, the general law of contract suggests that it is enough that the representation was actively present to the mind of the representee when he decided to make the contract. Therefore, in case of fraud, the law is less demanding of the person who is misled and seeking relief, and consequently little causal connection is required between the misrepresentation and the making of the contract. However, in a non-fraud misrepresentation in the general law of contract, inducement should be causal in the sense of decisive; that but for the misrepresentation the representee would not have made the contract at all or, at least, not on the same terms. In other words, the representee must act on it or must alter his position.⁹⁶

It would appear that this interpretation of actual alteration of the representee's position should be applied to the case of non-disclosure as the degree of inducement, considering the main purpose of recognition of actual inducement of the actual insurer in relation to the concept of the test of materiality in insurance contracts. In other words, as the degree of inducement, inducement should be decisive in the sense that, if the fact had been disclosed, the actual insurer would have refused to take the risk or insisted on different terms. The view that the test of materiality should be the decisive influence test seems to be caused by the fact that actual inducement had not been required. The main reason of recognition of the requirement of actual inducement is to allay the criticism of C.T.I. case which adopted the anti-decisive influence test as a standard of the test of materiality and denied the requirement of actual inducement. Lord Goff indirectly referred to the degree of inducement in insurance contracts ;

⁹⁶*Pulsford v. Richards* (1853) 17 Beav. 87, at p. 96 ; *Re Royal British Bank* (1859) 3 De G. & J. 387, at p. 422 ; *Re Universal Non-Tariff Fire Ins. Co.* (1875) L.R. 19 Eq 485, at p. 493 ; *Edgington v. Fitzmaurice* (1885) 29 Ch.D. 459, at pp. 467, 481 and 483 ; *Industrial Properties (Barton Hill) Ltd v. A.E.I. Ltd* [1977] Q.B. 580, at p. 597 ; *The Siboen* [1976] 1 Lloyd's Rep. 293, at p. 324 ; *Chitty on Contracts* (1989, 26th ed.) at para. 425 ; M. Clarke, "Insurers - influenced but yet not induced" [1994] L.M.C.L.Q. 473, at p. 476 ; *Actionable Misrepresentation*, at paras. 137ff.

"It was, I believe, because it was thought, in the C.T.I. case ... that actual inducement was not required, that critics of the decision in that case promoted the idea that the test of materiality should be hardened into the decisive influence test, by introducing into the concept of materiality something in the nature of inducement, though attributing it not to the actual underwriter but to the hypothetical prudent insurer. But once it is recognized that actual inducement of the actual underwriter is required, the pressure to take any such step disappears..."⁹⁷

It would appear the implication of this passage is that inducement in insurance contracts should mean what it does in the general law of contract in terms of the degree of inducement. In other words, the degree of inducement in insurance contracts should be actual alteration of the insurer's position for the worse. This interpretation seems to be consistent with the assumption that the validity of the representee's consent to the contract was undermined, which is the basis of avoidance of the policy on the ground of misrepresentation or non-disclosure. This interpretation is also consistent with Lord Mustill's words "using 'induced' in the sense in which it is used in the general law of contract" in introducing the requirement of actual inducement.⁹⁸

The issue of the requirement of actual inducement has been a long-standing argument over the last 200 years and regarded as a crucial point in relieving the insured from his too heavy and unfair burden. It would appear that the judgment on this issue in the House of Lords constitutes a great step forward in terms of protection for the insured. In other words, the requirement of actual inducement becomes very crucial, because the standard of the test of materiality has been set so low. However, its success largely depends on the interpretation and application of the presumption of inducement. The requirement of inducement can help the insured only if the burden of proof lies with the insurer. The insurer as a representee should prove that he was actually induced by the non-disclosure to enter into the contract. However, as a result of the application of the

⁹⁷[1994] 3 W.L.R. 677, at p. 683

⁹⁸*Ibid.*, at p. 712 ; For the analysis of the degree of inducement prior to the House of Lords' decision in *Pan Atlantic* case, see, M. Clarke, *The Law of Insurance Contracts*, (1994, 2nd ed.) at pp. 544-546

presumption of inducement, it is possible that the insured now has a burden to prove that there was no inducement at all and the insurer would have entered into the contract anyway. Therefore, the practical consequences would not be changed or would not be improved too much by the requirement of inducement if the presumption of inducement is widely applied in practice.

This requirement was approved again by the Court of Appeal in St. Paul Fire & Marine Insurance Co. Ltd v. McConnell Dowell Constructors Ltd⁹⁹ which has become the first case to consider the views of the House of Lords in the Pan Atlantic case. This case is particularly important because the Court of Appeal formulated the requirements of the application of the presumption of inducement, and indeed applied the presumption of inducement. In this case, among the four insurers, the underwriters of three of the insurers had given evidence, showing that if they had been aware of the true facts, they would not have underwritten the risk at the same premium on the same terms. From this evidence, the actual inducement of the three actual underwriters was sufficiently proved. However, as far as the fourth insurer, Prudential Assurance, is concerned, no underwriter was called to give evidence. This insurer would not be entitled to avoid their contract unless he could rely upon a presumption which would discharge the burden of proving inducement. Evans L.J., after considering the evidence of the three underwriters and of the expert witnesses, together with the fact that all four underwriters including the one from Prudential Assurance had accepted the risk without any relevant inquiries, held that there was a necessary presumption that the fourth underwriter had been also induced by the non-disclosure and misrepresentation. This presumption had not been rebutted. Therefore, the fourth insurer had discharged the burden of proving inducement, and consequently was entitled to avoid their liability.

⁹⁹(1995) 45 Construction Law Reports 89 ; Also see, Marc Rich & Co. v. Peter John Portman & Others (1995, unreported)

However, considering many cases in which other insurers are not often involved in the proceedings, the St. Paul case does not provide a clear answer to the question of how a court will deal with the presumption of inducement in the case where the actual underwriter does not give evidence.¹⁰⁰

6.3.1.4. RATIONALE AND VALUE FOR REQUIREMENT OF INDUCEMENT

6.3.1.4.1. GENERAL CONSIDERATION

If the state of mind of the actual insurer, i.e., the requirement of inducement, is not considered, a very unjust circumstance may occur. The particular underwriter who may readily confess in private that he would not have paid any attention at all to an undisclosed fact may hide behind expert evidence which is designed to show that a prudent underwriter would have considered it highly material. In that way, the particular underwriter may succeed in avoiding all liability under the contract. Eventually, the sloppy underwriter could be protected. Without the requirement for actual inducement, the principle of non-disclosure in insurance contracts may become weapons in the hands of the insurer calculated to scare the insured into doing its duty under threat of sometimes entirely excessive remedy for default. If each insurer is permitted to assess his premiums on one basis and yet take advantage of the practices of his colleagues once a dispute arises, it is a kind of distortion of competition.¹⁰¹ As to this possible unfairness, Waller J expressed his own view in the last part of his judgment at first instance in the Pan Atlantic case ;

"I have to say that I have at times felt some unease about finding that a failure to disclose these additional losses on the 1981 year, even though they were substantial, should entitle the defendants to avoid all liability, when their underwriter appears simply not to have been concerned to look at or take account of the most material part of the record in considering the risk."¹⁰²

¹⁰⁰For more detailed discussion on the issue of the presumption of inducement, see, sub-chapter 6.3.1.5. of this thesis.

¹⁰¹Merkin & McGee, at A.5.3-06

¹⁰²[1992] 1 Lloyd's Rep. 101, at p. 114

With the requirement of actual inducement, which was also approved by the Insurance Contract Act 1984 in Australia¹⁰³, the principle of duty of disclosure can be underpinned by a fair justification which creates a balanced mechanism.¹⁰⁴ Lord Mustill stated that in relation to the discussion of inducement of the actual insurer ;

"... to enable an underwriter to escape liability when he has suffered no harm would be positively unjust, and contrary to the spirit of mutual good faith recognized by section 17, the more so since non-disclosure will in a substantial proportion of cases be the result of an innocent mistake."¹⁰⁵

6.3.1.4.2. EFFECT OF IONIDES v. PENDER

It is beyond doubt that the test of materiality had required the inducement of the actual insurer until the middle of the 19th century. The turning point on this issue was the decision of Ionides v. Pender.¹⁰⁶ which introduced the concept of 'prudent insurer' for the first time in the courts and became the foundation of s. 18 of the M.I.A. 1906. The view that there is no room for the requirement of inducement seems to be based on this judgment. They argued that this decision was to replace the actual insurer by the prudent insurer in the test of materiality. Is this interpretation justifiable? As clearly expressed in the judgment, this decision was influenced by Parsons' proposed test of materiality ;

"...would a rational insurer governing himself by the principles and calculations commonly applied to policies and risks, have regarded these facts as bearing on those risks?"¹⁰⁷

¹⁰³Sections 28 and 29. If the insurer would have entered into the contract for the same premium and on the same terms and conditions, even if the insured had not failed to comply with the duty of disclosure or had not made the misrepresentation, no remedy is available.

¹⁰⁴p. Stanley, "Avoidance for misrepresentation or non-disclosure: Pan Atlantic v. Pine Top in the House of Lords" [1994] International Journal of Insurance Law 245, at p. 248

¹⁰⁵[1994] 3 W.L.R. 677, at p. 712

¹⁰⁶(1874) L.R. 9 Q.B. 531

¹⁰⁷*A Treatise on the Law of Marine Insurance and General Average* (1868) Vol. I. at p. 495

What circumstances led him to propose this new concept of 'rational insurer' in materiality? To find a possible answer, it is necessary to go back to Duer's definition of the test of materiality. He defined that a non-disclosure was only material if it not only induced the particular insurer to enter the contract, but also actually affected the risk to be insured against.¹⁰⁸ The purpose of Duer's view which required double factors was to relieve the insured of the unjust burden which would be placed on the insured if the materiality was to be decided only by the actual insurer.

It would appear that Parsons had the same sympathy for the insured as Duer did, and was influenced by Duer's proposed test of materiality,¹⁰⁹ although he had a different view as to scope of the duty of disclosure from Duer's view.¹¹⁰ Under this circumstance, the fundamental and general basis of making the new concept 'a rational insurer' was undoubtedly to seek to establish justice and fairness between the insurers and insureds in insurance contracts. In other words, the concept of rational insurer was made to prevent a possible absurd situation which might be a result from adopting only the particular insurer test. What Parsons did in the making of the rational insurer test was to object to the actual insurer test as a sole yardstick for determining materiality. He did not object to the actual insurer test itself, because he thought that the role of the actual insurer test was still required in terms of the inducement of the actual insurer. Parsons' test of materiality was adopted by Blackburn J. in *Ionides v. Pender*, saying ;

¹⁰⁸*The Law and Practice of Marine Insurance* (1846) Vol. II, at pp. 388 and 390

¹⁰⁹D. Kelly, "Recent Developments in relation to Inducement in Non-disclosure and Misrepresentation", (1988) 1 Ins. L.J. 30, at pp. 33-34

¹¹⁰Duer thought that materiality should be limited to the insured risks only, whereas Parsons thought that materiality is not limited to the risks insured ; *Ionides v. Pender* (1874) L.R. 9 Q.B. 531, *Rivaz v. Gerussi* (1880) 6 Q.B.D. 222 and *Tate & Sons v. Hyslop* (1885) 15 Q.B.D. 368 established that materiality was not limited to the insured risks.

"... it would be too much to put on the assured the duty of disclosing everything which might influence the mind of an underwriter. Business could hardly be carried on if this was required. But the rule laid down in *Parsons on Insurance*, vol. i. p. 495, that all should be disclosed which would affect the judgment of a rational insurer governing himself by the principles and calculations on which underwriters do in practice act, seems to us to be a sound one."¹¹¹

It would appear that the effect of *Ionides v. Pender* had not affected the question of inducement and that this was subject to the wider law on misrepresentation which, of course, required proof of actual reliance.¹¹² The effect of *Ionides v. Pender* was not to substitute the prudent insurer for the actual insurer. Blackburn J. did not suggest that inducement of the actual insurer should cease to be necessary. It was the addition of the prudent insurer test, not substitution. Therefore, the correct interpretation should be that the role of the actual insurer is still implicitly required, although the decision in *Ionides v. Pender* did not expressly refer to it. This interpretation is also supported by scholarly writings which were published after *Ionides v. Pender*.¹¹³ It would appear that this interpretation restates common law as to non-disclosure or "concealment" as it had first been laid down by Lord Mansfield in *Carter v. Boehm*.¹¹⁴

6.3.1.4.3. SECTION 18 OF M.I.A. 1906

As to the wording in s. 18 of the M.I.A. 1906 in which there is no mention of connection between non-disclosure and making the contract, three interpretations seem to be available. First, the common law did not require inducement and was correctly reproduced by the Act. Second, the common law did require inducement but Parliament

¹¹¹(1874) L.R. 9 Q.B. 531, at p. 539

¹¹²N. Fancourt and A. Gouge, "The English law of non-disclosure revised - The House of Lords decision in *Pan Atlantic v. Pine Top*", [1994] 10 Int'l I.L.R. 392, at p. 396

¹¹³See, the part of the History of interpretation of this requirement (6.3.1.2.) in this chapter.

¹¹⁴(1776) 3 Burr. 1905

did change it. Third, the common law did require inducement and the Act has the same effect. What is the correct interpretation?¹¹⁵

It is clear from the analysis of the development of legal thought and of the principle in the general law of contract that at the time when the M.I.A. 1906 was passed, the common law did require inducement, and the Act did not change the law. Even though Sir MacKenzie Chalmers did not clearly require the element of inducement in the M.I.A. 1906, the Act expressly preserve the rules of the common law.¹¹⁶ In other words, the view that ordinary rules of law applied to the M.I.A. 1906 was assumed. Likewise, the common law on inducement has not been affected by the enactment of the M.I.A. 1906. Therefore it must be assumed that the Act expected there to be inducement as well. Any insurer who argues that material fact was not disclosed or there was a material misrepresentation has to show that he was thereby actually induced into entering the contract. That was the common law at the time when the Act of 1906 was passed and it remains so today. In other words, the prevailing position in terms of the law is that actual inducement is still required. It is worth noting that the concept of inducement is clearly distinct from materiality, and it should not be regarded as a component of materiality. On this basis, a requirement of inducement of the actual insurer would not be inconsistent with the test of materiality in the M.I.A. 1906.

6.3.1.4.4. COMPATIBILITY WITH GENERAL LAW OF CONTRACT

The irrelevance of an opinion of the actual insurer to determine materiality in non-disclosure in insurance contract law raises one question in relation to general contract law. In general contract law, a misrepresentation is only actionable if it induced the

¹¹⁵*Pan Atlantic Insurance Co. v. Pine Top Insurance Co.* [1994] 3 W.L.R. 677, at p. 706

¹¹⁶S. 91 of the M.I.A. 1906 "... save in so far as they are inconsistent with the express provision of this Act..."

representee to enter the contract. Therefore, unless the representee has been influenced, he has not been misled and consequently the misrepresentation cannot be actionable. It is because misrepresentation under this circumstance does not undermine the validity of the representee's consent which is the basis of the contract in question. Likewise, a requirement of subjective materiality, i.e., the opinion or the influence of the representee in question is crucial in misrepresentation in the general law of contract.¹¹⁷

This position should be the same in the case of non-disclosure in insurance contracts, although the relevant sections of the M.I.A. 1906 only refer to the "judgment of a prudent insurer" with no reference to the words of the requirement of inducement of the actual insurer. What, then, is the justification, if any, for insurance law's departure from general contract law in this regard? Why should the law be more favorable to an insurer seeking to avoid a contract of insurance? Why should utmost good faith require the assured to disclose a fact which the actual insurer would not recognize as material?¹¹⁸

No convincing reason has yet been given for the difference in dealing with the issues of non-disclosure and misrepresentation in insurance law from general contract law. The consideration of the inequalities of knowledge between insured and insurer, which is the basis for introducing the duty of disclosure in insurance contract cannot in logic or justice be the reason of insurance law's departure from the general law of contract. It is odd to admit the departure of the law of insurance in the issues of non-disclosure and misrepresentation from the principle of the general law of contract. In principle, if an insurer, having paid no attention to the non-disclosure and misrepresentation, has suffered no injustice thereby, he should not be allowed to avoid the policy on the ground of non-disclosure or misrepresentation. This requirement surely confirms the simple rule that the law of insurance is all part of the law of contract. Consequently, the law of

¹¹⁷H. Bennett, *Ibid.*, at p. 514

¹¹⁸*Pan Atlantic Insurance Co. v. Pine Top Insurance Co.* [1994] 3 W.L.R. 677, at p. 729

insurance should not proceed according to peculiar and abnormal rules unless they are absolutely necessary.

6.3.1.4.5. SECTION 18(3)(B) OF M.I.A. 1906

The interpretation which regards an opinion of the actual insurer as a relevant factor seems to be consistent with s. 18(3)(b) of the same act ;

"In the absence of inquiry, the following circumstances need not be disclosed, namely:...(b) Any circumstance which is known or presumed to be known to the insurer. The insurer is presumed to know matters of common notoriety or knowledge, and matters which an insurer in the ordinary course of his business, as such, ought to know;"

This section shows that, in the absence of inquiry, no duty to disclose anything that the actual insurer may happen to know is imposed on the insured. It is because anything that the actual insurer may happen to know is unlikely to induce him to enter the contract. In this context, it is right to say that the requirement of the inducement of the actual insurer is implicitly contained in this section.¹¹⁹ Therefore, the correct interpretation of the provision is as follows ; the "prudent insurer test" in materiality *per se* does not give a right to avoid the policy unless the additional test of the requirement of inducement of the actual insurer passes.¹²⁰

6.3.1.4.6. OTHER RATIONALE FOR REQUIREMENT OF INDUCEMENT

It has been said that the requirement of actual inducement might reduce the anxiety caused by the decision of the anti-decisive influence test, because, as a result of the

¹¹⁹A. Diamond referred to the principle of *uberrima fides* as another reason for supporting Kerr J's decision in *Berger v. Pollock*. He said that "s. 17 discloses an intention that the utmost good faith should be observed by both parties to the contract and s. 18 should be construed in the light of this and not so as to enable the actual insurer to take advantage of the 'prudent insurer' test of materiality if he would not himself have been influenced by the undisclosed circumstances." See, his article, "The law of marine insurance - has it a future?" [1986] L.M.C.L.Q. 25, at p. 31

¹²⁰Merkin & McGee, at A.5.3-06-07

requirement of actual inducement, more attention will be paid to the actual party in the contract and to his own way of assessing the risk in question.¹²¹ This requirement might help to guard against the insurer setting up a defense based on non-disclosure because he would have to show that he had paid attention to information about the risk and that he had been affected by non-disclosure. However, it is true that success of this requirement of actual inducement in terms of restriction to the insurer largely depends on the application of the presumption of inducement.

In addition, the recognition of the requirement of actual inducement might remove one of the four obstacles to awarding a remedy of damages for non-disclosure which were discussed by the Court of Appeal in *La Banque Financiere de la Cite v. Westgate Insurance Co. Ltd.*¹²²

6.3.1.5. PRESUMPTION OF INDUCEMENT - RELATIONSHIP BETWEEN TWO REQUIREMENTS -

6.3.1.5.1. GENERAL CONSIDERATION

Will the decision of the Pan Atlantic case significantly change the shape of litigation of misrepresentation and non-disclosure in insurance contracts? What exactly has been changed and does it matter in practice? As far as the test of materiality is concerned, it is left where it stood with the C.T.I. case in 1984. However, the requirement of actual inducement was newly added to avoid the insurer's liability. Even before the decision of the House of Lords in the Pan Atlantic case was delivered, the actual underwriter was often called in the witness box to show that he was affected by the non-disclosure of a material fact, which was a common practice by the prudent lawyer who advised the

¹²¹M. Clarke, "Insurers-influenced but yet not induced", [1994] L.M.C.L.Q. 473, at p. 475

¹²²[1988] 2 Lloyd's Rep. 513, at p. 550 (the second obstacle) ; See, the sub-chapter 7.7. of this thesis.

insurers. Now, as a result of the decision of the House of Lords in the Pan Atlantic case, this practice will be more crucial in future proceedings.

As to the effect of this decision, some have taken the view that, while the differences of opinion as to the interpretation of the test of materiality are of importance, the potential consequences of it have been reduced by the decision of the requirement of actual inducement of the actual insurer. It might be said that, with regard to the criticisms of the C.T.I.'s test of materiality, which are mostly concerned with objection to the law's apparent assistance of an imprudent insurer especially in the case of inadvertent non-disclosure, most of them would appear to have been removed by the House of Lords' decision in the Pan Atlantic case that the actual insurer should be induced by non-disclosure and misrepresentation to enter into the contract to avoid the policy in question.¹²³ It is true that the requirement of actual inducement will make the defense of non-disclosure a less technical defense, which has been widely used by the insurers in insurance industry.

However, the question of whether the contention that the insured would benefit by the requirement of the insurer's actual inducement is right or wrong largely depends on how widely the practice of the presumption of inducement is applied and also depends on in what way the presumption of inducement is interpreted in practice. This is because the burden of proof of inducement can be passed to the insured from the insurer as a result of presumption of inducement. In principle, the burden of proof of inducement lies with the insurer who seeks to avoid the contract, and clearly the requirement of inducement can only help the insured if the burden of proof lies with the insurer.

¹²³*St. Paul Fire and Marine Insurance Co. Ltd v. McConnell Dowell Constructors Ltd* (1995) 45 Construction Law Reports 89, at pp. 101-102 ; Also see, *Pan Atlantic Insurance Co. Ltd v. Pine Top Insurance Co. Ltd* [1994] 3 W.L.R. 677, at p. 683 (Lord Goff) ; N. Fancourt and A. Gouge, *Ibid.*, at p. 396

However, some doubt has arisen as to proof of inducement in non-disclosure because Lord Mustill in the Pan Atlantic case observed, in relation to the recognition of the actual insurer's inducement, that there is a presumption of inducement in both the general law of contract and the law of insurance. According to Lord Mustill's reasoning, it would appear that once the insurer has satisfied the court that a prudent insurer would have been influenced by the misrepresentation or non-disclosure of a material fact, it may be assumed that the actual insurer was in fact so induced. In other words, it seems that because a fact was material, there is a presumption that the insurer in question was induced. Therefore, it is unlikely that the burden of proof lies with the insurer, and consequently the burden passes to the insured to show that the insurer would have entered into the contract anyway.

It would appear that Lord Mustill broadly accepted the presumption of inducement which can put an unfair burden upon the insured, in that it is incumbent on him to rebut this presumption. The current situation in the case of non-disclosure, which has been criticized over the years, is not likely to be improved in practice by the decision of the House of Lords in the Pan Atlantic case, if the above interpretation of the presumption of inducement is adopted. The effect of the breach of the duty of disclosure is still all-or-nothing. It is still a prudent underwriter who plays a major role in deciding materiality. In addition, an imprudent insurer could be still in a favorable position compared with an insured who is inadvertently in breach of the duty of disclosure as a result of the practice of the presumption of inducement.

Therefore, as to the effect of the House of Lords' decision in the Pan Atlantic case, it would appear that almost nothing has been changed in practice. The position of the insured seems to be unchanged when one considers the fact that the presumption would be very difficult to rebut. If this interpretation is adopted as Lord Mustill did, the insured will be as badly treated by the law of non-disclosure after the Pan Atlantic case as he was before this decision..

6.3.1.5.2. CORRECT INTERPRETATION OF PRESUMPTION OF INDUCEMENT

Where it is established that misrepresentation is material, the question of whether the insurer was actually induced by the misrepresentation depends on what evidence is given by the underwriters. In general, the burden to prove inducement as well as materiality lies on the insurer. If the underwriters give evidence that they would have acted differently, had the fact been disclosed, the court will decide the question of inducement based on the underwriters' evidence. In this case, it is a common practice that the lawyers for the insured try to establish by cross-examination that there was no inducement. Likewise, when the underwriters give evidence in relation to the issue of inducement, there will be little room for the question of the presumption of inducement because most of questions can be answered by underwriters' evidence.

However, what has to be done to satisfy the requirement of inducement, if the underwriters prove materiality but do not give evidence in relation to the issue of inducement for one reason or another? There may be presumption of inducement. If there is no presumption, the insurer who gives no evidence will fail in satisfying the requirement of inducement.

Apart from the types of presumptions in which no basic fact is required, presumptions, which will be considered here, require the proof of a basic fact. It seems that there are three possible ways to treat the presumption of inducement.¹²⁴ The first is irrebuttable presumption of law. It means that the existence of a presumed fact *must* be drawn on proof of a basic fact, and all rebutting evidence is inadmissible. In other words, if a basic fact is established, it is legally equivalent to proof of the presumed fact. Therefore, if this

¹²⁴Generally see, *Cross on Evidence* (5th ed., 1979), Ch. VI and *Cross & Tapper on Evidence* (8th ed. by C. Tapper, 1995), Butterworths, Ch. III ; *Murphy on Evidence* (5th ed., 1995), Blackstone Press Ltd, Ch. 4.

is adopted, the additional requirement of the actual inducement would mean that it had in fact added nothing to the law as it stood prior to the decision of the House of Lords in the Pan Atlantic case, because the court had given it with one hand and taken away it with the other.

The second view is rebuttable presumption of law. This rebuttable presumption of law can be divided into two groups. The first group is that the existence of the presumed fact *must* be drawn on proof of a basic fact in the absence of evidence to the contrary. In other words, the presumed fact *must* be found to exist on proof of a basic fact unless sufficient evidence to the contrary is adduced. In this presumption, an evidential burden has been cast on the opponent of the presumed fact. (evidential presumption) The second group is that the existence of the presumed fact *must* be drawn on proof of a basic fact unless the court is persuaded to the appropriate standard of the contrary. In this case, the effect of this presumptions is to place the persuasive burden of disproving the presumed fact on the party against whom they operate. (persuasive presumption) Likewise, in the case of the rebuttable presumption of law (both evidential presumption and persuasive presumption), the burden of proof has been shifted to the insured from the underwriters. These two kinds of presumptions of law can be described as strong presumptions.

The third approach is presumptions of fact. Unlike the above two types of presumptions of law in which the presumed fact must be drawn, presumption of fact means that the presumed fact *may* be found to exist on proof of a basic fact and the court is not obliged to draw the presumptions as a matter of law even though there is no further evidence. Presumption of fact, which is the weakest form of presumption, is based on the circumstantial evidence which the law may recognize as sufficient to discharge a burden of proof borne by the underwriters relying on presumptions. In other words, presumptions of fact derive their force from common sense and logic, whereas presumptions of law derive their force from law. Presumptions of fact are always

rebuttable. According to this approach, the presumption of inducement will come into play, for example, in those cases in which the underwriter cannot give evidence and there is no reason to suppose that the actual underwriter acted other than prudently in writing the risk.¹²⁵ If this is adopted, the presumption of inducement seems to be relegated to a kind of last resort, and has added very little to what had been found by the other Law Lords in the Pan Atlantic case - that the requirement of actual inducement is a necessary pre-requisite for the insurer to prove to be entitled to avoid the contract.

Among the above three interpretations, which presumption should be adopted in relation to the presumption of inducement in the Pan Atlantic case? It would appear that the third approach is the correct interpretation. In other words, the correct interpretation should be that if the insurer proves materiality and gives no evidence for inducement, the judge *may* rely on the presumption of inducement.

If the judge is obliged to rely on the presumption of inducement, in other words, if the law is that once materiality is proven, inducement will be presumed, then the insurer will win the most cases except those cases where the insured can prove non-inducement, which is very difficult to do so in practice. In addition, this interpretation will weaken the pressure on the insurer to provide evidence on inducement. It is undesirable to have a rule that makes it easy that the insurer avoid providing evidence on inducement. If the House of Lords in the Pan Atlantic case adopted this interpretation, almost nothing will be changed or improved in practice in terms of the protection of the insured. In other words, if the strong presumptions are adopted, the requirement of inducement will have no effect in most cases in practice, and almost nothing will be added to the law as it stood prior to the decision of the House of Lords in the Pan Atlantic case.

¹²⁵Marc Rich & Co. v. Peter John Portman & Others (1995, unreported) Transcript, at p. 32

Among the five Law Lords in the Pan Atlantic case who unanimously accepted the requirement of actual inducement, only Lord Mustill referred to a presumption of inducement. His interpretation of a presumption of inducement seems to be that once the insurer has satisfied the court that a prudent insurer would have been influenced by the misrepresentation or non-disclosure of a material fact, it may be assumed that the insurer in question was in fact so induced. In other words, it seems that because a fact was material, it would also have been an inducement. He several times referred to the insured's burden to prove that the actual insurer would not have been induced, which is really difficult to do so in practice. As to the onus of proof on inducement, Lord Mustill said that ;

"... I have concluded that it is an answer to a defense of misrepresentation and non-disclosure that the act or omission complained of had no effect on the decision of the actual underwriter. As a matter of common sense... the assured will have an uphill task in persuading the court that the withholding or misstatement of circumstance satisfying the test of materiality has made no difference. There is ample material both in the general law and in the specialist works on insurance to suggest that there is a presumption in favor of a causative effect. "¹²⁶

The correct view should be that inducement cannot be inferred in law from proved materiality.¹²⁷ Lord Lloyd expressed his objection to the view of the presumption of inducement as a matter of law, which was upheld in *Redgrave v. Hurd*¹²⁸, saying that "this heresy has long been exploded."¹²⁹ He also showed his negative attitude toward the wide application of the presumption of inducement by regarding the two requirements (materiality and inducement) as totally distinct ones and by taking the requirement of actual inducement as a starting point unlike Lord Mustill.¹³⁰ Therefore,

¹²⁶[1994] 3 W.L.R. 677, at pp. 713-714

¹²⁷*Halsbury's Laws of England* (4th ed., 1983) Vol. 31, at para. 1067

¹²⁸(1881) 20 Ch.D. 1, at p. 21

¹²⁹*Pan Atlantic Insurance Co. Ltd v. Pine Top Insurance Co. Ltd* [1994] 3 W.L.R. 677, at p. 731

¹³⁰Therefore, the question of materiality arises only after actual inducement has been proved. *Ibid.*, at p. 732 ; Merkin & McGee, at A.5.3-08

according to Lord Lloyd's reasoning, there is little room for the automatic presumption of inducement from proven materiality. On the facts, he decided for the reinsurer on the issue of inducement, not because the reinsurer benefited from a presumption but because of the circumstances of the case. In other words, his presumption of inducement was based on the circumstantial evidence, which supports the view of presumptions of fact which means that the presumed fact *may* be found to exist by the court on proof of a basic fact.¹³¹

In addition, it may be inferred that Lord Goff took a negative view of the presumption of inducement as a matter of law by connecting the main reason for acceptance of the requirement of actual inducement with the anti-decisive influence test.¹³² He stated that the insurer's proof of actual inducement was required to satisfy those who maintain the decisive influence test as a test of materiality. This may be seen as indicating that Lord Goff is not in favor of the presumption of inducement, since the presumption of inducement as a matter of law will shift the burden of proof from the insurer to the insured, which obviously makes the advocates for the decisive influence test disappointed.

Two recent cases also confirmed the view that inducement cannot be inferred in law from proved materiality, and it is for the insurer to prove inducement. In *St. Paul Fire and Marine Co. Ltd v. McConnell Dowell Constructors Ltd*¹³³, Evans L.J. did not adopt a presumption of inducement as a matter of law for the Prudential Assurance Co. who had not given evidence on inducement. If he had adopted a presumption of inducement from proved materiality as a matter of law, the court might easily have decided for the insurer, because there was no evidence from the insured to rebut the

¹³¹M. Clarke, "The significance of silence - Non-disclosure again", [1995] L.M.C.L.Q. 477, at p. 479

¹³²[1994] 3 W.L.R. 677, at p. 683

¹³³(1995) 45 Construction Law Report 89

presumption. However, Evans L.J. considered the circumstances of the case such as the force of the actual evidence on inducement from the other underwriters, and concluded that there was no evidence to displace the presumption that the Prudential Assurance Co. like the other underwriters was induced. In other words, his interpretation of presumption was based on the circumstantial evidence. It would appear that this interpretation is correct one.

In addition, in *Marc Rich & Co. v. Peter John Portman & Others*¹³⁴, Longmore J., who is also one of the editors on a leading insurance law textbook - *MacGillivray & Parkington on Insurance Law* -,¹³⁵ said that presumption will only come into play in which the underwriter cannot (for good reason) give evidence and there is no reason to suppose that the actual underwriter acted other than prudently in writing the risk. He also said that it is for the insurer to prove that the non-disclosure did induce the writing of the risk on the terms in which it was written.¹³⁶ These two recent cases clearly show their objection to the strong presumption that because a fact is material it is also an inducement.

6.3.1.5.3. REBUTTAL OF PRESUMPTION OF INDUCEMENT

To rebut the presumption of inducement, which will be by no means an easy matter, the insured should collect evidence and many expert opinions as much as possible regarding the question of the test of materiality, and should establish absence of actual influence of non-disclosure of misrepresentation of a material fact, even though the chances of success of rebuttal are very low. In other words, the insured should try to find evidence which shows that the undisclosed or misrepresented fact would not have mattered to the

¹³⁴(1995, unreported)

¹³⁵(1988, 8th ed. by M. Parkington, N. Legh-Jones, A. Longmore and J. Birds)
Sweet & Maxwell

¹³⁶*Ibid.*, Transcript, at p. 32

actual underwriter and would not have caused him to act differently. One of the possible defenses to rebut the presumption of inducement is to show that the actual insurer was foolish, imprudent and careless in the process of underwriting the risk. By showing his foolishness, it can be assumed that the actual insurer would not have been induced by those which were not disclosed. In other words, the presumption of inducement is much diminished if it can be shown that the actual underwriter was careless in the process of underwriting the risk in question. Therefore, the insured should pay attention to the manner in which the actual underwriter wrote the risk.

It would appear that another possible way to rebut the presumption is related to the majority view of the test of materiality (non-decisive influence test). To avoid the contract, the insurer will prove that a prudent insurer would have taken a non-disclosed fact in question into consideration. According to the non-decisive influence test, the non-disclosed fact would not have changed the prudent insurer's decision. In order to rebut the presumption of inducement, the insured can maintain, from this anti-decisive influence test, that it can be inferred that the non-disclosed fact did not have a decisive influence on the actual underwriter because he is also supposed to be a prudent underwriter. This view can be supported by the practice whereby the insurer has to bring evidence to show that the actual underwriter is a prudent underwriter by submitting him to cross-examination.¹³⁷ In addition, this second defense could be used to support the view that the test of materiality should be the decisive influence test. If the test of materiality, which should be an objective test, is interpreted in the meaning of 'might', which seems to be the majority view in the House of Lords in the Pan Atlantic case, it seems less logical to presume from this proven materiality that the underwriter in question would have been *actually* induced by the non-disclosed fact.

6.3.1.5.4. CONCLUSION

¹³⁷Also see, P. Stanley, *Ibid.*, at p. 249

Lord Goff warned of the danger of considering the two questions in watertight compartments because they interact. The requirement of actual inducement has an impact upon the question of materiality.¹³⁸ It is possible to say that since the view of the decisive influence test which is applied to the prudent underwriter has appeared in relation to the rejection of the role of the actual underwriter, the view that the test of materiality should be the decisive influence test becomes no longer necessary as a result of the recognition of the actual inducement of the actual underwriter. In other words, according to the test of materiality which was upheld by the House of Lords in the *Pan Atlantic* case, it is unnecessary for the expert underwriter who represents the prudent insurer to say what action he would have taken if he had been aware of the true facts. However, it would clearly be useful for the expert underwriter to state what action he would have taken had he possessed the true facts, because the court may rely on his evidence in applying the presumption of inducement to the case. In other words, even though the decisive influence test for materiality was rejected, the shadow of it may remain in the territory of the requirement of actual inducement. Indeed, the two questions are bound up with each other.

The presumption of inducement should arise only in an exceptional circumstance. Materiality itself is not enough to establish the presumption, unless the materiality is glaringly obvious. In other words, the presumption that the underwriter in question is actually induced should only arise where the materiality is so obvious as to justify the inference as a matter of fact. Therefore, something more than mere materiality is needed. In conclusion, it would appear that the wide and reckless application of the presumption of inducement will destroy the original purpose of the recognition of the requirement of actual inducement in non-disclosure in insurance contracts - the protection of the

¹³⁸*Pan Atlantic Insurance Co. Ltd v. Pine Top Insurance Co. Ltd* [1994] 3 W.L.R. 677, at p. 683

insured. Therefore, the application of the presumption of inducement in practice should be made with extra caution.

CHAPTER 7. RECIPROCITY OF PRINCIPLE OF DUTY OF DISCLOSURE

7.1. GENERAL CONSIDERATION

The mutual trust and confidence between insurer and insured have been regarded as a basis of the contract of insurance. This special relationship requires a higher degree of good faith between them. A higher degree of good faith i.e. the duty of utmost good faith between the parties in the contract of insurance means that each party is obliged to disclose to the other all information which would influence the other's judgment to enter the contract. This principle of duty of disclosure was clearly enunciated by Lord Mansfield in *Carter v. Boehm*¹ and his well-known judgment has been regarded as the best justification for this principle ;

"Insurance is a contract upon speculation. The special facts upon which the contingent chance is to be computed, lie most commonly in the knowledge of the assured only: the underwriter trusts to his representation, and proceeds upon confidence that he does not keep back any circumstance in his knowledge, to mislead the underwriter into a belief that the circumstance does not exist"²

From the above passage, it is not easy to find any particular reason why this duty should be mutual. It seems to be the insurer who is in a vulnerable position concerning non-disclosure of any material fact. In practice, the duty of disclosure is mostly applied to the prospective insured, because he alone knows or should know the great amount of information material to the consideration of the contract.

Nevertheless, the duty applies to the insurer as well, since it is possible to imagine a case in which the special facts lie outside the possession of the insured, in other words, lie in the possession of the insurer only. For instance, where the insurer knows that the vessel proposed for marine insurance had in fact already sunk, unknown to the owner, the

¹(1776) 3 Burr. 1905

²Ibid., at p. 1909

insurer's withholding of this information is a breach of the duty of disclosure based on the principle of utmost good faith. Another good example may be seen in a case where the insurer issues a policy with a war risks exclusion clause for an insurance of goods on transit to a place. During the negotiation, war in the place of the policy was not likely to break out. However, the war was in fact in a touch-and-go situation, and later it was known to the insurer, but not to the insured when the insurer issued the policy. The insured, who did not know of it, sent the goods and consequently lost the goods due to the war. In this situation, it is possible to say that the insurer breached the duty of utmost good faith, because he failed to disclose this material fact to the insured.³ Lord Mansfield expressed his view on this issue, which has had a great influence on the tendencies of other countries' courts in deciding the issue of the insurer's duty of utmost good faith, in *Carter v. Boehm* ;

"The policy would equally be void, against the underwriter, if he concealed; if he insured a ship on her voyage, which he privately knew to be arrived: and an action would lie to recover the premium.... Good faith forbids either party by concealing what he privately knows, to draw the other into a bargain, from his ignorance of that fact, and his believing the contrary..."⁴

According to Lord Mansfield's reasoning as to the mutual nature of the duty of utmost good faith, the insurer was required to play a positive role to obtain certain relevant information. In *Carter v. Boehm*, Lord Mansfield held that the allegedly concealed fact, i.e., condition of the place, was something which the insurer might be informed in various way, saying that it was not a matter within the private knowledge of the insured only. The insurer's positive role to gain access to the relevant information would include making his own inquiry, and this role would reduce the scope of the insured's absolute duty in some sense.⁵

³J. Birds, "Insurer's duty of utmost good faith; damages for non-disclosure", [1986] J.B.L. 439, at p. 442.

⁴(1776) 3 Burr. 1905, at pp. 1909-1910

⁵See, *Deaves v. C.M.L. Fire & General Insurance Co. Ltd* (1979) 23 A.L.R. 539, at p. 580

In addition, s. 17 of the M.I.A. 1906 also makes it clear that the duty of utmost good faith is mutual, stipulating it in bilateral terms. Likewise, the principle of *uberrima fides* is that both parties have the same or similar duty to help each other to make the decision and not to mislead each other for their own interests. In fact, in making an insurance contract, each party appraises its position by all information which he can obtain. As far as the insurer is concerned, he will accept the risk after a full analysis of all the available information and calculation about the right premium. In contrast, the insured will enter into a contract after he compares the risk with the premium. Therefore, it would be wrong for insurance law to require the insured to supply all material information to the insurer, but to impose no duty of disclosure on the insurer.

The traces of this nature of reciprocity can be also found in Re Bradley and Essex and Suffolk Accident Indemnity Society.⁶ In this case, the insurer refused to pay a workers' compensation claim on the basis that a condition precedent as regarding the keeping of a wages book was not complied with. Farwell L.J. held that the insured was not bound by conditions in the policy unless he was informed of and consents to them before the policy was effected, saying that ;

"Contracts of insurance are contracts in which *uberrima fides* is required, not only from the assured but also from the company assuring... it is especially incumbent on insurance companies to make clear, both in their proposal forms and in their policies, the conditions which are precedent to their liability to pay."⁷

However, the issue of the insurer's duty to disclose in this case was indirectly discussed, and the other judges expressed different views.⁸ This principle of reciprocity was more

⁶[1912] 1 K.B. 415

⁷Ibid., at p. 430

⁸Also see, Mutual Reserve Life Insurance v. Foster (1904) 20 T.L.R. 715 ; Provincial v. Morgan [1933] A.C. 240, where Lord Russell of Killowen said that the insurer's duty of good faith was related with making the form of proposal and the form of policy in clear and unambiguous terms. See, J. Birds, Ibid., at p. 441, footnote 24

directly approved in *Horry v. Tate & Lyle Refineries Ltd*⁹, which had been regarded as a leading authority on this issue in English case law before this issue began in earnest in the late 1980s. In this case, Pain J. held that the insurers were under a duty to disclose that the sum offered was on the low side, and the insurers should have made sure that the plaintiff understood that if he accepted the money, it would be an end of the matter, and that the plaintiff should have had an opportunity to test himself back at work and to think over the offer.

Surprisingly enough, however, the duty of disclosure by an insurer, apart from the above authorities, had appeared very little in English insurance case law until the late 1980s. It had lain in an inert state. In other words, in England, this principle of the duty of disclosure had almost unilaterally rested upon those proposing insurance (insured) rather than upon those underwriting it (insurer). It would appear that the application of the duty of utmost good faith in England had not followed the original intention of Lord Mansfield's decision -reciprocity and equality -. This tendency was reflected in the M.I.A. 1906, which stipulates the insured's duty of disclosure, whereas there is no provision for the insurer's duty to disclose. In practice, the necessity of the application of the insurer's duty to disclose material facts to the insured does not seem to happen frequently, because it is rare for the insurer to be in a position where he knows something important of which the insured is not aware. In other words, material facts to insurance are generally in the hands of the proposed insured. Therefore, the insured's duty of disclosure is much more required than that of the insurer's. This rarity of occurrence seems to be one of the reasons why the question of awarding damages for breach of the duty of disclosure has not called the courts' attention, because in most cases, the remedy of avoidance of the policy can be an effective remedy to the insurer.

7.2. INSURER'S DUTY OF UTMOST GOOD FAITH IN THE U.S.A.

⁹[1982] 2 Lloyd's Rep. 416

7.2.1. INSURER'S DUTY OF DISCLOSURE

The insurer's duty of disclosure has been acknowledged and approved by the American courts.¹⁰ Bowler v. Fidelity and Casualty Co. of New York¹¹ has been regarded as a landmark decision on the issue of the insurer's duty of disclosure in the U.S.A. In this case, Bower had a disability policy which entitled him to payment for 200 weeks if something designated in the policy happened. If the disability was not cured in 200 weeks, he was entitled to another payment for 600 weeks. At the end of 200 weeks, the insurer's doctor made a report that he was able to work and was not completely disabled, although the doctor admitted that the condition of his leg was very poor. Bower did not take legal action for more than 6 years which was the statute limitation for taking legal action. After the statute limitation had passed, he made a claim against the insurer. The court clearly accepted that the insurer was under a duty to disclose the existence of the time limitation for setting up a legal action saying that ;

"Insurance policies are contracts of utmost good faith and must be administered and performed as such by the insurer.... In all insurance contracts, particularly where the language expressing the extent of the coverage may be deceptive to the ordinary layman, there is an implied covenant of good faith and fair dealing that the insurer will not do anything to injure the right of its policyholder to receive the benefits of his contracts.... In these circumstances it has *the duty to speak and disclose*, and to act in accordance with its contractual undertaking. The slightest evidence of deception or overreaching will bar reliance upon time limitations for prosecution of the claim."¹²

The principle of the insurer's duty of disclosure is well established in the American courts. However, it would appear that the broader concept of the insurer's duty of good faith and fair dealing has been more prevalent in the U.S.A.

¹⁰Generally see, A. Podolsky, "Insurer's Duty to Disclose the Existence of a Policy", (1976) 76 Columbia L.R. 825 ; R. Hasson, "The Special Nature of the Insurance Contract : A Comparison of the American and English Law of Insurance", (1984) 47 M.L.R. 505

¹¹250 A. 2d. 580 (1969)

¹²Ibid. at pp. 587-588

7.2.2. INSURER'S DUTY OF GOOD FAITH AND FAIR DEALING¹³

In the U.S.A., in certain circumstances, if a contract is breached in a particular way, a right of action can arise in tort as well as in contract. It would appear that this practice is strongly related with the concept of the duty of good faith and fair dealing in contract. In the U.S.A., there has been a wide recognition of the implied covenant of good faith and fair dealing in every contract that neither party will do anything to injure the right of the other to receive the benefits of the contract.¹⁴ The breach of this implied covenant of good faith and fair dealing gives rise to a liability in tort as well as in contract. The concept has particularly developed in insurance litigations and most of the cases which deal with this concept are found in insurance field in which the insurer is blamed for mishandling the insured's claim. The expression of "good faith and fair dealing" was used in Communale v. Traders and General Insurance¹⁵ which dealt with the insurer's unreasonable refusal to pay the money. The court said;

"There is an implied covenant of good faith and fair dealing in every contract that neither party will do anything which will injure the right of the other to receive the benefits of the agreement."¹⁶

It is now well recognized that the insurer is bound by an implied covenant of good faith and fair dealing with the insured, and the insurer's breach of this implied covenant of

¹³See, M. Cohen, "Reconstructing Breach of the Implied Covenant of Good Faith and Fair Dealing as a Tort", (1985) 73, California Law Review 1291 ; C. Vinicombe, "North Carolina's cautious approach toward the imposition of extracontract liability on insurers for bad faith", (1986) 21 Wake Forest Law Review 957 ; E. Ailts, "A New Tort for Texas : Breach of the Duty of Good Faith and Fair Dealing", (1987) 18 St. Mary's Law Journal 1295 ; C. Hunt, "Ohio Recognizes Tort Duty of Good Faith and Fair Dealing Between An Insurer and Its Insured", (1984) 10 University of Dayton Law Review 159 ; Also see, A. Podolsky, Ibid. ; R. Hasson, "Good Faith in Insurance Law - Some Lessons from Insurance Law" (1987-1988) 13 Can. Bus. L.J. 93, at pp. 112-120 ; T. Scotford, "The Insurer's Duty of Utmost Good Faith Implications for Australian Insurers", (1988) 1 Ins. L.J. (No. 2) 1, at pp. 10-11

¹⁴Communale v. Traders and General Insurance 328 P.2d 198 (1958) ; Bowler v. Fidelity Casualty Co. of N.Y. 250 A. 2d. 580 (1969)

¹⁵328 P.2d 198 (1958)

¹⁶Ibid., at p. 200

good faith and fair dealing can give rise to a liability in both contract and tort. Therefore, not only contractual damages but also extra contractual damages such as mental distress damages and economic consequential damages can be awarded.¹⁷ Moreover, if the insurer's behavior is intentionally malicious and oppressive, punitive damages may also be granted for a tort breach. For example, in Fletcher v. Western National Life Ins. Co.¹⁸, the principle that the duty of good faith is imposed upon the insurer in dealing with the settlement was affirmed. The insured took out a disability policy which entitled him to monthly payments of \$150 for up to 30 years in the case of total disability. He got seriously injured. After an operation, he returned to work, but shortly after he was dismissed by his employer because he could not work. As a defense of the claim, the insurer argued that the insured was ill rather than injured. Furthermore, the insurer argued that the insured had made a misrepresentation by not disclosing his congenital back injury, which was referred to by the insurer without any convincing and substantial evidence. In fact, the insurer paid only for 2 years under the illness part of the policy, and stopped. Not surprisingly, the insured brought a claim for compensatory damages and for punitive damages. The court held that the insurer was liable for a bad faith denial of liability in the contract, therefore the insurer was liable for both compensatory damages and punitive damages.¹⁹

In the U.S.A., the concept of fiduciary relationship between insurer and insured in the contract of insurance was also introduced in relation to application of this implied covenant of good faith and fair dealing in practice.²⁰ In other words, the insurer owes a fiduciary duty based on the nature of the insurance contracts, which is the mutual trust

¹⁷Manchester Insurance and Indemnity Co. v. Grundy 531 S.W. 2d 493 (1975)
; Gruenberg v. Aetna Insurance Co. 510 P.2d 1032 (1973)

¹⁸10 Cal. App. 3d 376 (1970)

¹⁹Similar decisions can be found in Gruenberg v. Aetna Insurance Co. 510 P. 2d. 1032 (1973)

²⁰Rova Farms Resort Inc. v. Investors Insurance Co. of North America 323 A.2d 495 (1974)

and confidence between them. Likewise, in the U.S.A., the insureds have been reasonably well protected through the implied covenant of good faith and fair dealing imposed on the insurer, which is obviously burdensome for the insurer.

7.3. RECENT DEVELOPMENT OF INSURER'S DUTY OF DISCLOSURE IN ENGLISH INSURANCE CONTRACTS

7.3.1. GENERAL CONSIDERATION

It would appear that the recent two cases, Banque Keyser Ullmann S.A. v. Skandia (U.K.) Insurance Co. Ltd²¹, which in the Court of Appeal became La Banque Financiere De La Cite S.A. v. Westgate Insurance Co. Ltd²² (hereafter the Skandia case) and The Bank of Nova Scotia v. Hellenic Mutual War Risks Association (Bermuda) Ltd (The Good Luck)²³ (hereafter the Good Luck case) are extraordinarily important for the issue of the insurer's duty of disclosure. These two cases clearly expressed that the insurer's duty of disclosure is required as much as the insured. It was not surprising for the insurers in the Skandia case at first instance to challenge this nature of reciprocity of the duty of utmost good faith, considering the past trend to which the insurers had been used, and a bulk of authorities which had been unilaterally in favor of the insurer. The insurers denied any such duty imposed on them and also maintained that it did not have any relevant content. However, the reciprocity was firmly established in the Skandia case not only by Steyn J. at first instance, but also by the higher courts.

7.3.2. NATURE AND IMPORTANCE OF THESE TWO CASES

²¹[1987] 1 Lloyd's Rep. 69

²²[1989] 2 Lloyd's Rep. 513 ; [1990] 2 Lloyd's Rep. 377

²³[1988] 1 Lloyd's Rep. 514 ; [1989] 2 Lloyd's Rep. 238 ; [1991] 2 Lloyd's Rep.

These decisions surely rang an alarm against the present unfair and unbalanced practice of the duty of disclosure. The effect of the judgments on this issue will have a great influence on the practice in insurance markets. The positive acknowledgment of the reciprocity of duty surely provides relief to the insured. In addition, some crucial questions in relation to the insurer's duty to disclose such as the ambit of the insurer's duty of disclosure, the test of materiality and the insurer's continuing duty of disclosure, were also discussed in these cases. Furthermore, the insurer's duty of disclosure to the assignee of the proceeds of the policy was dealt with in the Good Luck case.

The issue of the common law duty of care owed to the insurers was also discussed. In fact, this principle may be more applied in other transactions where special relationships between the parties exist and only one party knows that his opponent is likely to be in trouble owing to the deliberate wrongdoing of a third party in dealings between them.²⁴ The implication of this issue in the law of insurance may be of significance in terms of the protection of the insureds along with the nature of the reciprocity of the duty of disclosure. The importance of this duty of care may be found in dealing with the possibility of awarding damages to the insureds, since this duty of care may be regarded as one of the alternatives to the duty of disclosure in terms of awarding damages to the insureds. This was not an easy task for the courts to decide, because the courts had to deal with this question of the common law duty of care owed to the insurers for the first time, although the seed of this rationale can be found in Anns v. Merton London Borough Council.²⁵

The relatively new question of whether or not the fiduciary relationship exists between the insureds and the insurers was raised at first instance in the Skandia case. Some relationships such as trustee and beneficiary, parent and child, solicitor and client etc.

²⁴P. Matthews, "Insurer's Liability Extended", [1987] L.M.C.L.Q. 5, at p. 10

²⁵[1978] A.C. 728, at pp. 751-752

have been understood as examples of the fiduciary relationship. However, the category of fiduciary relationship is not closed²⁶ and this term of fiduciary relationship is very comprehensive and is used in a loose sense.²⁷ In the U.S.A. the fiduciary relationship between the insurer and the insured, at least in liability insurance, has been widely recognized²⁸ and this tendency seems to extend to other kinds of insurance.²⁹ In England, the question of whether the relationship between the parties in an insurance contract has a fiduciary nature has been hardly discussed in the courts.³⁰ This issue can be closely linked with the question of the remedies for the breach of the duty, and may provide a new theory in relation to the question of the basis of the duty of disclosure.³¹ Likewise, these two cases directly or indirectly deal with some decisive issues which have been regarded as crucial for the development of the law of insurance. Most of the issues are concerned with the question of the general protection of the insureds, who have been in a weak position in the English courts and insurance industry.

These two cases are very complicated. There were some unusual factors which made these cases so complicated. Firstly, both cases do not directly deal with claims under insurance policies, i.e., the claims for the insurer's duty of disclosure were not under the policies in question. Secondly, the big swindler Ballestero and his fraudulent partners in the Skandia case were not the parties to this complicated litigation. Thirdly, the Good Luck case is not a case between the insurer and the insured. The bank in this case was

²⁶English v. Dedham Vale Properties Ltd [1978] 1 W.L.R. 93, at p. 110.

²⁷Re Reading's Petition of Right [1949] 2 All E.R. 68, at p. 70.

²⁸Crisci v. Security Insurance Co. 426 P.2d 173 (1967) (Calif. S.C.) ; Gruenberg v. Aetna Insurance Co. 510 P.2d. 1032 (1973) (Calif. S.C.) ; Florida Farm Bureau v. Rice 393 So.2d. 552 (1980) (Florida C.A.)

²⁹Egan v. Mutual of Omaha Insurance Co. 598 P.2d. 452 (1979) (Calif. S.C.) ; Hoskins v. Aetna Life Insurance Co., 452 N.E. 2d. 1315 (1983) (Ohio S.C.)

³⁰See, Horry v. Tate & Lyle Refineries Ltd [1982] 2 Lloyd's Rep. 416

³¹As to the legal basis of the duty of disclosure, including the fiduciary nature as a basis of the duty, see, Chapter 3 of this thesis.

the only assignee of the proceeds of the policy, not the assignee of the policy itself. Therefore, the bank could not be the insured and other people remained as insured.

In addition, in the Skandia case, the changes of the names of the parties during the litigations between the decision at first instance and that of the Court of Appeal also made this case more complex. Banque Keyser Ullmann S.A. changed its name to La Banque Financiere De La Cite S.A. in the Court of Appeal. The appeals were in fact made by two insurers, Hodge and Skandia. However, Skandia withdrew its appeal and the other banks assigned their claims to Banque Financiere. Eventually, Hodge (renamed Westgate) and Banque Financiere were appellant and respondent, respectively. Likewise, the facts and circumstances of the Skandia case are extremely peculiar. Lord Bridge described the peculiar nature of this case, saying ;

"at the end of this long and complex litigation the outcome is dictated by a short point on the construction of the fraud exclusion clause as applied to a combination of circumstances of a very unusual nature which is unlikely ever to be repeated."³²

Lord Templeman also said that;

"Proceedings in which all or some of the litigants indulge in over-elaboration cause difficulties to judges at all levels in the achievement of a just result. Such proceedings obstruct the hearing of other litigation. "³³

Considering that the facts of these two cases are extremely complicated and the main issues are regarded as very crucial in the history of the law of insurance contracts, high attention to the judgments and their implications is required in analyzing them. The precise legal analysis of these two momentous decisions will surely contribute to the development of law of insurance contracts.

7.3.3. THE FACTS OF THE SKANDIA CASE³⁴

³²[1990] 2 Lloyd's Rep. 377, at p. 380

³³Ibid., at p. 388

Between December 1979 and March 1981 a group of banks including Banque Keyser Ullmann S.A. was persuaded to make a series of loans to four companies owned or controlled by a Spanish businessman named Jaime Balletero for the development of a tourist complex called Shangri-La. The securities provided for these loans were both a quantity of gemstones and a credit insurance which was regarded as the primary security by the banks, guaranteeing repayment of the loans by the insurers if the banks were not repaid by the borrowers and the sale of the gemstones did not cover the remaining indebtedness. The insureds were borrowing companies, but in effect the banks were the insureds, either as co-insured because they were named as co-insureds on the policies or as assignees of the benefit of the policies. The policies were arranged by a firm of Lloyd's brokers Ernest A. Notcutt & Co. Ltd. via its employee, Roy Lee. This broker acted as the agent of the insured parties (the banks) and not of the insurers, according to the ordinary practice in the London insurance market. All the policies contained a "fraud exclusion clause" which expressly excluded liability on the insurers' part for any claims arising directly or indirectly out of fraud by any party.

In late 1979, Lee contracted one Cyril Dungate, underwriter at Hodge General & Mercantile Insurance Co. Ltd., in order to place the insurance. As to the insurance for the first loan, Hodge, through Dungate, took 100% of the primary layer of insurance. However, Hodge declined to do more on the two excess layers (the loans concerning these layers were supposed to be made available in January 1980) than to hold covered for a maximum of 14 days, while Lee eagerly tried to obtain the further cover elsewhere in the market. Lee knew that the banks would not make any loans until the cover was fully completed. The 14-day temporary credit insurance on a loan which was supposed to last for 2 years did not satisfy the banks at all. Lee, who was anxious about the

³⁴It is undoubtedly necessary to fully understand the complicated facts of these two cases in order to substantiate the necessity of the requirement of the insurer's duty of disclosure.

commission, behaved dishonestly at this stage. In January 1980, he sent the banks cover notes in which Lee deliberately concealed the fact he had only held a cover note valid for 14 days. In fact, Lee obtained the full cover for the two excess layers over the next few months. The banks, relying on Lee's cover notes, released the loans to those companies.

In June 1980, Dungate became aware of the existence of the fraudulent cover notes made by Lee in January 1980 and also found part of the cover was still incomplete even in early June 1980. He knew that the deception might be repeated, as in fact it was, and the banks would refuse to make further loans subsequent to June 1980 if the deception of Lee was disclosed to them. At the same time, he understood his firm would consequently lose the commissions on later credit insurances. However, he failed to tell Hodge who quitted its business in October 1980 and later Skandia or Lee's superior at Notcutts (who, as the trial judge found, would have told the banks and dismissed Lee, if they had known) and also failed to alert the banks about the frauds of their broker. Instead of this, Dungate continued to deal with them and write further insurance policies which were also managed by Lee for the banks. Some months later, Ballestero sought further loans from the banks and the banks asked the brokers to arrange additional insurance to cover those loans. Lee once again made fraudulent cover notes. In consequence, further loans were made by the banks who had no knowledge of Lee's fraud. This time, however, Lee could not achieve the full cover for the fraudulent cover notes. By March 1981, in total, four subsequent loans had been made, amounting to 80 million Swiss francs. In due course the four borrowing companies defaulted on the loans and Ballestero and the funds disappeared. The gemstones proved to be almost valueless and it was then discovered that Ballestero, his companies and some of those who had certified the value of the gemstones had been involved in a huge fraud. As the real value of the gemstones pledged did not cover the remaining debt of the four companies, the banks sought to claim under their credit policies.

In the course of the proceedings, the banks became aware of Lee's fraud, and consequently the banks brought actions against Notcutts and Lee for negligence and fraud respectively. In addition, the banks claimed against Dungate's employers (Hodge and later Skandia) for Dungate's failure to disclose the dishonesty of Lee to them. At the start of the trial Notcutts accepted liability in the sum of £10.5 million and settled with the banks. Then, they sought to recover the residual loss from their insurers. However, after the trial began, the banks accepted that, as a result of G.I.A.'s fraudulent valuation on the gemstones made by Ballestero, they had no claim against the insurers under the policies because of the "fraud exclusion clause" in the policies. Nevertheless, the banks sued insurers on a different cause of action. As part of the contention, they insisted, alleging that the insurers owed them a duty of utmost good faith and the common law duty of care, that such duties required insurers to disclose to them the dishonest behavior of Lee, and that the breach of these duties in this case entitled them to damages from the insurers in the amount of those loans.

7.3.4. THE FACTS OF THE GOOD LUCK CASE

The Good Luck was one of the ships owned by the Good Faith Shipping Co., with the aid of a loan from the plaintiff, the Bank of Nova Scotia. The plaintiff held a mortgage over the Good Luck for a condition of loan. The shipping company insured the Good Luck against war risks with the defendants, a mutual war risk insurance company. In relation to the war risk policy, the insurers were given a notification that the benefit of all insurance policies was assigned to the plaintiff. A letter of undertaking was given to the plaintiff from the defendants, under which the insurance was to be held for the benefit of the plaintiff and a duty was imposed on the defendants to notify the plaintiff immediately if the policy ceased to insure the ship. The vessels of the Good Faith Group, including Good Luck, were regularly chartered to Iranian interests for voyages into the Persian Gulf and into the Iranian port of Bandar Khomeini which were designated as an additional premium area and a prohibited area by rule 20 of the club. Since November

1981, the defendants had discovered that the shipping company had been sending its ships into an additional premium area as well as a prohibited area, without notice to the defendants, but had taken no steps to inform either the shipping company or the plaintiff of the facts.

On 6 June 1982, the Good Luck, which was in a prohibited zone via the Persian Gulf without notifying the insurer was hit by a missile. As a result of this, she became a constructive total loss. On 14 June 1982, the plaintiff inquired of the defendants what the position was as to the shipping company's claim made from the incident of 6 June. While the insurers told the shipowner that the Good Luck was in a breach of warranty in the insurance policy, and therefore she was not insured by them, the insurers' answer to the plaintiff's inquest was that the claim was being dealt with in the usual way without mentioning Good Luck's breach of warranty and the effect of it. In July, the plaintiff, who thought that the shipowner would be entitled to receive the amount of the loss from the insurers, increased the amount advanced to the shipping company. It is clear that the further loan would not have been made, if the plaintiff had known that on that day the ship was in a prohibited area, and that the defendants was therefore likely to reject the claim. On 4 August 1982, the insurers, not surprisingly, rejected the claim of Good Faith on the grounds that the Good Luck was in a prohibited zone via an additional premium area without giving notice when she was hit by a missile and became a constructive loss. The plaintiffs sought to recover damages which they advanced to the shipowner, arguing that the insurer had broken the terms of the letter of undertaking and broken the duty to disclose based on the concept of utmost good faith. The plaintiff also argued that the club were liable in tort for negligently failing to inform the bank of what they knew, giving rise to economic loss, which could be another basis of claim for damages.

7.4. ANALYSIS OF INSURER'S DUTY OF UTMOST GOOD FAITH

The trial judge, who considered the decision of Lord Mansfield in *Carter v. Boehm* and the general wording of s. 17 of the M.I.A. 1906, held that the obligation of the utmost good faith was reciprocal and therefore was owed not only by the insured but also by the insurer to each other. The reciprocity of the duty of utmost good faith was approved by the higher courts. The insurer's duty of utmost good faith includes both a duty to abstain from bad faith and a duty to observe the utmost good faith in disclosing all material facts with the test of good faith and fair dealing. The requirements for an actionable non-disclosure by the insurer are presumably the same as those in the insured's non-disclosure. Therefore, the insurer must have failed to make disclosure, the non-disclosure must have been of a fact, it must have induced the insured to enter into the contract, and the insurer must have been aware, or ought reasonably to have been aware, that it would do so.

7.4.1. SCOPE OF INSURER'S DUTY TO DISCLOSE

7.4.1.1. GENERAL CONSIDERATION

The next question, which follows the endorsement of the insurer's duty of disclosure, is how and to what extent this principle should be carried out when it applies to the insurer. In other words, the scope and the nature of the insurer's duty is the next question. These questions are very important, because, unless precise yardsticks to operate this principle are provided, this principle will be extremely difficult to implement in practice, and consequently the original purposes of this principle, which are justice, fairness and equality in insurance contracts between the parties, will disappear again.

The meaning of materiality may be different, depending on whether the duty of disclosure is imposed on an insured or an insurer. The question of the test of materiality for the insurer's duty of disclosure has never been authoritatively studied with reliable support from the courts, and there is very little literature in this field. Furthermore, the M.I.A. 1906 which is regarded as a statutory base for the reciprocity of the duty of

disclosure only provides the definition of materiality in regard to the insured's duty in ss. 18 to 20. Under these circumstances, the implications and underlying meanings from the ss. 18 to 20 of the M.I.A. 1906 must be cautiously considered along with s. 17 of the M.I.A. 1906 in order to explore the scope of the insurer's duty of disclosure and the test of materiality.

Some guidance for delimiting the scope of the insurer's duty of disclosure may be also found from the judgment of Lord Mansfield in *Carter v. Boehm*, which implies that the insurer's duty is the mirror image of the insured's duty. As part of the ambit of the insured's duty of disclosure, the insured must inform the insurer of the facts which increase the risk, whereas the facts which decrease the risk to be insured need not be disclosed to the insurer. Lord Mansfield expressed the following passage in order to explain the nature of reciprocity of the duty of disclosure ;

"The policy would be equally void, against the underwriter, if he concealed; as, if he insured a ship on her voyage, which he privately knew to be arrived, and an action would lie to recover the premium."³⁵

From the example of this passage, the fact which the insurer must disclose to the insured is the fact that the ship has already arrived. The fact of the arrival of a ship is something which decreases (in fact, eliminates) the risk to be insured. From Lord Mansfield's judgment, it would appear that the insurer's duty of disclosure is restricted to the facts as to the risk which would induce the insured either not to insure or to insure for a lower premium. Likewise, Lord Mansfield's view sees the insurer's duty of disclosure in fairly narrow terms. This view was supported by Lord Jauncey in the House of Lords.³⁶ This interpretation seems to faithfully reflect the concept of a mirror image of the insured's duty in relation to the insurer's duty of disclosure.

7.4.1.2. STEYN J.'S VIEW

³⁵(1776) 3 Burr. 1905, at p. 1909

³⁶[1990] 2 Lloyd's Rep. 377, at p. 389

7.4.1.2.1. STEYN J.'S PROPOSITION

At first instance in the Skandia case, Steyn J., who held that the insurers were just as much under the duty of disclosure as were the insured, rejecting the insurer's contention that any duty on an insurer to be of utmost good faith had no relevant content, said ;

"In considering the ambit of the duty of the disclosure of the insurers, the starting point seems to me as follows: in a proper case it will cover matters peculiarly within the knowledge of the insurers, which the insurers know that the insured is ignorant of and unable to discover but which are material in the sense of being calculated to influence the decision of the insured to conclude the contract of insurance."³⁷

Steyn J. then insisted that the above passage should not be regarded as a definition of the test of materiality. He suggested that the test of materiality should be added and reinforced by the concept of 'good faith and fair dealing', saying that ;

"In considering whether the duty of disclosure is activated in a given case a Court ought, in my judgment, to test any provisional conclusion by asking the simple question: Did good faith and fair dealing require a disclosure?"³⁸

According to the above test, a fact is material and ought to be disclosed by an insurer if a failure to disclose would amount to a breach of good faith and fair dealing and if the non-disclosure would influence the insured in determining whether or not to conclude the contract. It would appear that the influence of the non-disclosed fact on the insured covers not only the decision to conclude the contract but also the decision of any contractual terms such as warranties, or exceptions.³⁹ In the Skandia case, the insurer had information on the honesty or sincerity of a broker who arranged the place of the risk on behalf of the insured. This information was only in the hand of the insurer and the insured was ignorant of and not able to discover it. Furthermore, the insurer knew that disclosure of dishonesty of the broker would mean no further business would take

³⁷[1987] 1 Lloyd's Rep. 69, at p. 94

³⁸Ibid., at p. 94

³⁹Law Commission Report No. 104 (1980) Cmnd. 8064, at para. 4.48

place. Under these circumstances, there was no doubt that the facts undisclosed by the insurer in the Skandia case were material and the leading underwriters were in breach of the duty of disclosure, considering the concept of good faith and fair dealing. Steyn J. said on this matter ;

"If good faith and fair dealing has any meaning at all, it seems to me that there was a clear duty on Mr. Dungate to place the relevant facts before the banks. This view is reinforced by the contemporary morality of the market."⁴⁰

It is clear that Steyn J. regarded the concept of good faith and fair dealing as a crucial standard on the issue of the test of materiality. The background of his reasoning seemed to be related to his evaluation of the current morality of the insurance market. What he wanted to do in making the test of materiality was to try to bring a high standard of morality into the insurance market by introducing the concept of good faith which in the context can be understood as a meaning of honesty and fair dealing in relation to the insurer's conduct and business. Therefore, if the insurer is aware of the existence of some circumstances which would influence the insured in acting upon his transaction, good faith requires the insurer to disclose those circumstances.

7.4.1.2.2. CRITICISM

It might be said that the meaning of 'calculated' in his test is too wide. The strict interpretation of Steyn's proposed test - a fact which is 'calculated' to influence the decision of the insured to conclude the contract of insurance - might include the situation where the non-disclosed fact has no relationship with the risk of the insurance or the recoverability of the claim, as long as the fact is interpreted to influence the insured's decision. It might be said that the word 'calculated' in Steyn J.'s proposed test has a somewhat similar meaning to the words 'impact on the formation of opinion or decision-making process in the proposed test provided by the Court of Appeal in

⁴⁰[1987] 1 Lloyd's Rep. 69, at p. 95

Container Transport International Inc. v. Oceanus Mutual Underwriting Association Ltd (Bermuda)⁴¹.

Steyn J.'s second method on the test of materiality - good faith and fair dealing - might give rise to the some difficulties in practice. He did not define the meaning of good faith and fair dealing in detail. Instead, he referred to the practice and contemporary morality of the market in relation to the meaning of those concepts. It would appear that his idea is concerned with the meaning in the American Uniform Commercial Code in which good faith in respect of merchants has been defined as honesty in fact and the observance of reasonable commercial standards of fair dealing in the trade.⁴² However, it seems that, in relying on this concept in determining the materiality of a fact, there might be some practical difficulties to identify or to prove the standard of the insurance market and its morality, which are very important factors in applying his test of materiality in practice.⁴³ In other words, it might be said that the changeable character of good faith and fair dealing could be an obstacle to adopting them as a standard of the test of materiality and the scope of the insurer's duty of disclosure in practice.

Despite the above criticism, however, it would appear that Steyn J.'s introduction of the standard of good faith and fair dealing in determining the scope of the insurer's duty of disclosure is instructive, because it could be used to protect the insured in practice. It might be possible to say that the courts in the Skandia case should not allow the insurer to rely on the exclusion clause for fraud, because it might be said that the insurer breached the duty of good faith and fair dealing, therefore the insurer's reliance on the clause in this situation is inconsistent with the concept of good faith and fair dealing. In

⁴¹[1984] 1 Lloyd's Rep. 476, at p. 492 ; Also see, H. Yeo, "Of reciprocity and remedies - duty of disclosure in insurance contracts", (1991) 11 Legal Studies 131, at p. 135

⁴²Uniform Commercial Code, 2-103(1)(b)

⁴³H. Yeo, "*Uberrima Fides* - Reciprocity of Duty in Insurance Contracts", (1988) 2 Review of International Business Law (No. 3) 271, at pp. 284-286

other words, the concept of good faith and fair dealing might prevent the insurer from relying on the fraud exclusion clause.⁴⁴ In this aspect, the insured could be protected by this standard.

In addition, the criticism as to the wide and obscure meaning of good faith and fair dealing might be modified by the fact that the position of the insurer is totally different from that of the insured in terms of practical knowledge, experiences in the insurance markets and making contracts, and the opportunities to access to the information, data and the assistance from his colleagues and legal experts etc. These differences perhaps makes it possible that the conceivable worrying situations which may be referred to by those who criticize Steyn J.'s test will be prevented or substantially modified. As to the criticism of the possible wide meaning of "calculated", this criticism would be modified by the recent decision of the House of Lords in Pan Atlantic Insurance Co. Ltd v. Pine Top Insurance Co. Ltd⁴⁵, which required the additional element of the actual inducement in non-disclosure. Based on this, it would appear that it is instructive for the trial judge to introduce the concept of good faith and fair dealing in determining the scope of the insurer's duty of disclosure.

7.4.1.3. COURT OF APPEAL'S VIEW

7.4.1.3.1. COURT OF APPEAL'S PROPOSITION

The Court of Appeal agreed with Steyn J.'s view that the insurer was under the duty to disclose material facts to the insured. However, the Court of Appeal expressed some disagreement with the trial judge as to what was a material fact which should be disclosed and how it should be defined. The Court of Appeal rejected the good faith and

⁴⁴See, Curtis v. Chemical Cleaning and Dyeing Co. [1951] 1 K.B. 805 ; Also see, J. Birds, *Modern Insurance Law* (1993, 3rd ed.), Sweet & Maxwell, at p. 113, footnote 9 ; "Insurer's duty of utmost good faith; damages for non-disclosure", [1986], J.B.L. 439, at pp. 442-443

⁴⁵[1994] 3 W.L.R. 677

fair dealing test, because they did not think that the insurer was under a duty to disclose everything which might affect the judgment of the insured. According to the good faith and fair dealing test, an insurer could be under a duty to disclose the existence of another reputable insurer who is prepared to underwrite the same risk at a substantially lower premium. However, the duty to disclose the insurer's awareness that cheaper cover is available elsewhere in this example is not imposed on the insurer in practice, as such a fact is not linked with the risk of the insurance or the recoverability of the claim. The Court of Appeal provided a different yardstick in determining the scope of the insurer's duty of disclosure, which is substantially narrower than that of Steyn J.'s ;

"In our judgment, the duty falling on the insurer must at least extend to disclosing all facts known to him which are material either to the nature of the risk sought to be covered or the recoverability of a claim under the policy which a prudent insured would take into account in deciding whether or not to place the risk for which he seeks cover with that insurer."⁴⁶

Applying this test, the Court of Appeal agreed with the view of the trial judge that Mr. Dungate in the Skandia case was under a duty to disclose the deceit of the broker to the insured, and eventually the leading underwriters were in breach of the duty of disclosure imposed on them. It would appear that different reasons exist both for insured and for insurer as to the necessity of the principle of the duty to disclose material facts. It seems that these different reasons were considered by the Court of Appeal in formulating the test of materiality. As far as the insurer is concerned, he seems to be more interested in the facts which may affect the risk to be insured because he has to decide whether or not he will accept the risk and, if so, at what premium and on what terms. On the other hand, as far as the insured is concerned, he is more concerned with the recoverability of his claim. The insurer's duty of disclosure is necessary for the protection of the insured, and the insured's main interest seems to lie on the recoverability of his losses in the event of accident.⁴⁷

⁴⁶[1988] 2 Lloyd's Rep. 513, at p. 545

⁴⁷H. Yeo, "Of reciprocity and remedies - duty of disclosure in insurance contract", (1991) 11 Legal Studies 131, at pp. 135-136

In practice, the insurer's breach of duty, in most cases, will be concerned with the facts that are material to the recoverability of a claim under the policy, because any fact which is material to the nature of the risk to be covered is often known by the insured. Applying the Court of Appeal's proposed test, the insurer seems to have a duty to disclose to the insured the apparent meaning and ambit of the coverage and the terms under the policy, in so far as the insured could not be expected to be aware of it.⁴⁸ If the conduct of a person is related to recoverability under the policy, it also should be disclosed to the insured by the insurer. The Skandia case is a good example of it.

7.4.1.3.2. CRITICISM

It is questionable whether the Court of Appeal's extending to the recoverability under the policy will be useful in practice, considering the fact that the insured is not entitled to damages where the policy proves not to cover his loss. The Court of Appeal formulated the test of materiality for the insurer's duty of disclosure which solely depends on the likely effect of the undisclosed fact on the prudent notional insured.⁴⁹ It would appear that the Court of Appeal thought that it was logical to say that the standard for the test of materiality in relation to the insurer's duty of disclosure should be the same or similar as that spelt out for the insured's duty of disclosure in s. 18 of the M.I.A. 1906. The main reason of introduction of the standard of the prudent insurer by the courts in the case of the insured's duty of disclosure was to protect the insured against the idiosyncrasies of the particular insurer.

However, unlike the case of the insured's duty of disclosure, it would appear that the insurer is unlikely to be at risk caused by the idiosyncrasies of the particular insured,

⁴⁸This interpretation conflicts with the decision in *Re Hooley Hill Rubber & Chemical Co. Ltd* [1920] 1 K.B. 257 in which it was held that a false statement by the insurer's agent as to the coverage of the policy could not give rise to remedies.

⁴⁹[1988] 2 Lloyd's Rep. 513, at pp. 545 and 550

considering the position of the insurer compared with that of the insured. Consequently, it would appear that, unlike the case of the insured's duty of disclosure, there is no real need to introduce the standard of the prudent notional insured in the case of the insurer's duty of disclosure. In theory, this view that the effect of the non-disclosure on the mind of the particular insured is relevant could be reinforced by the decision of the House of Lords in Pan Atlantic Insurance Co. Ltd v. Pine Top Insurance Co. Ltd⁵⁰ which required the additional element of the actual inducement of the actual insurer.

As to the reason given by the Court of Appeal in order to narrow the scope of the insurer's duty of disclosure - according to the good faith and fair dealing test, an insurer could be under a duty to disclose the existence of another reputable insurer who is prepared to underwrite the same risk at a substantially lower premium -, it seems to be unacceptable. It would appear that the alleged fact in this example is something which the insured ought reasonably to inquire into in the ordinary course of his business which is to find an insurer, because differences of premium in the markets can be easily found by the insured himself. Therefore, by analogy of s. 19 of the M.I.A. 1906 which deals with some exceptions in relation to the insured's duty of disclosure, the insurer does not have to disclose the above fact to the insured even under the good faith and fair dealing test formulated by Steyn J. at first instance.⁵¹

7.4.1.4. HOUSE OF LORDS' PROPOSITION

This issue was not discussed in any detail in the House of Lords. Lord Bridge did not dissent from the proposed test of materiality by the Court of Appeal. This Court of Appeal's proposed test was also approved by Lord Brandon and Lord Ackner.⁵²

⁵⁰[1994] 3 W.L.R. 677

⁵¹Also see, D. Kelly & M. Ball, *Principles of Insurance Law in Australia and New Zealand* (1991) Butterworths (Sydney), at pp. 149-151

⁵²[1990] 2 Lloyd's Rep. 377, at pp. 380, 381 and 388

However, although Lord Bridge agreed with the test of materiality proffered by the Court of Appeal, he did not agree with the Court of Appeal's conclusion that the broker's deceit was a material fact which should be disclosed by the insurer. Their Lordships thought that the broker's fraud had not contributed to the insured's inability to recover under the policy and it did not affect recoverability of a claim within the Court of Appeal's test. Therefore, their Lordships thought that the broker's fraud would not have entitled the insurers to avoid liability and it was neither a matter that affected the risk nor a fact that could be held to be material to the recoverability of a claim under the policy.

Only Lord Jauncey considered this issue in detail. It seems that he confined the insurer's duty to those facts which directly affect the risk to be insured under the policy. It can be understood that his view was a mirror image of the scope of the insured's duty, He said ;

"The duty extends to the insurer as well as to the insured.... The duty is, however, limited to facts which are material to the risk insured, that is to say, facts which would influence a prudent insurer in deciding whether to accept the risk and, if so, upon what terms, and a prudent insured in entering into the contract on the terms proposed by the insurer. Thus any facts which would increase the risk should be disclosed by the insured and any facts known to the insurer but not to the insured, which would reduce the risk, should be disclosed by the insurer."⁵³

In other words, Lord Jauncey thought that just as the insured must disclose to the insurer any facts known to him but not to the insurer which increase the risk, so also the insurer must disclose to the insured any facts known to the insurer but not to the insured which decrease the risk. Lord Brandon and Lord Ackner agreed with Lord Jauncey's view.⁵⁴ It would appear that Lord Jauncey established the insurer's duty of disclosure in fairly narrow terms. This view is very similar to Lord Mansfield's view on this issue. According to Lord Mansfield's reasoning, the insurer should disclose to the insured the facts which decrease the risk in question. Apart from a policy on a ship known to have

⁵³Ibid., at p. 389

⁵⁴Ibid., at pp. 381 and 388

arrived safely as an example of material facts which decrease the risk,⁵⁵ another example for the insurer's duty of disclosure would be the insurance against fire in a house which, the insurer knew, had been demolished.

In *Skandia* case, according to his test of materiality, the insurer's duty of disclosure could not extend to the deceit of the broker which neither increased nor decreased the risk to be insured. Based on this, the broker's fraud was not a matter which required disclosure. The decision of the House of Lords over the issue of the test of materiality for the insurer's duty of disclosure has been said to be something of a disappointment. It is not easy to define the test of materiality provided by the House of Lords with a single sentence. The reason is that Lord Bridge and Lord Jauncey had different views on this issue, while Lord Brandon and Lord Ackner merely expressed their agreement with the approaches of both Lord Bridge and Lord Jauncey without comment. Furthermore, Lord Templeman did not mention the duty of insurer and its scope at all. It does not seem that Lord Jauncey's test of materiality, which mainly focuses on the risk rather than the recoverability, is more useful to the insured, considering the fact that the insured is much more concerned with the recoverability of the claim under the policy after making a contract with the insurer.

It is not easy to find any big difference in practice between the Court of Appeal's test and Lord Jauncey's test, because the breach of the insurer's duty to disclose could not result in damages. Moreover, in practice, even though the test of materiality of Lord Jauncey which focuses on the relationship between undisclosed facts and their influences on the risk to be insured is adopted, in most cases, any fact which strongly relates to a claim (i.e. recoverability) should be additionally required to disclose it. In other words, facts such as a ship entering a war zone or an insured failing to disclose all facts relevant

⁵⁵(1776) 3 Burr. 1905, at p. 1909

to a claim should be additionally disclosed. It would appear that both tests are merely different ways of spelling out what is essentially the same ambit.⁵⁶

7.4.2. CONSTRUCTIVE KNOWLEDGE IN INSURER'S DUTY

The question of whether or not the ambit of the insurer's duty of disclosure includes constructive knowledge, and if so, what is the scope of it is a relatively new issue. None of the proposed tests of materiality for the insurer's duty of disclosure by the courts in the Skandia case explicitly dealt with the question of constructive knowledge in relation to the scope of the duty. The test of materiality proposed by Steyn J. covered 'matters peculiarly within the knowledge of the insurer'⁵⁷, whereas the Court of Appeal's test which was approved by the House of Lords referred to 'all facts known to him (the insurer)'⁵⁸. Do such knowledge or all facts include constructive knowledge beyond the actual one? In other words, apart from the facts which are actually known to him, should the insurer also disclose knowledge of those facts known to his agents but not to him personally as well as those facts which should be known to him in the ordinary course of business?⁵⁹

The starting point should be what is the nature of the insurers in the current insurance industry. Generally speaking, insurers are huge commercial companies. They have a lot of experience in carrying out their business. They are also acquainted with practical matters and the current customs in London insurance markets. Furthermore, their positions grant them very easy access to invaluable or decisive information, which

⁵⁶H. Yeo, *Ibid.*, at p. 140

⁵⁷[1987] 1 Lloyd's Rep. 69, at p. 94

⁵⁸[1988] 2 Lloyd's Rep. 513, at p. 545 ; [1990] 2 Lloyd's Rep. 377, at pp. 380, 381 and 388

⁵⁹An attention must be paid to the word 'ordinary'. It means that the knowledge which is only available through a highly special investigation by the insurer is not within the scope of constructive knowledge of the insurer.

would be within the scope of the duty of disclosure, through the large data collection procedure and advice from advanced technical experts.

For marine insurance cases, this question could be settled by the implications in ss. 17 and 18 of the M.I.A. 1906. The reasons why the constructive knowledge can be included in the scope of the insured's duty of disclosure in marine insurance cases⁶⁰ can be applied to the case of the insurer's duty of disclosure, considering the above nature of the insurers in the modern insurance industry. Therefore, as far as marine insurance cases are concerned, the constructive knowledge is within the ambit of the insurer's duty of disclosure.

For non-marine insurance cases, the reasons as to why constructive knowledge should not be included in the insured's duty of disclosure, although it is included in practice, seem to lose their cogency when applied to the insurers. The underlying reason why constructive knowledge should not be imputed to the insured's duty of disclosure in non-marine insurance cases is that the requirement for constructive knowledge from the insured is beyond reasonable expectation, considering the nature of the insured.⁶¹ However, the nature of the insurers in the current insurance industry - big commercial enterprises with a power to easily collect a lot of information such as the customs of the trade, business practices, common notoriety and knowledge that any generally well informed person ought to know - is quite different from that of the insured. Constructive knowledge can be relatively easily discerned by insurers in the ordinary course of their business. Seen in this light, it is not unreasonable to expect that the constructive knowledge can be included in the scope of the insurer's duty of disclosure.

⁶⁰In marine insurance cases, the insureds are, in many occasions, commercial enterprises. Consequently, the insureds are generally acquainted with business practices and the customs of the trade.

⁶¹For the question as to the constructive knowledge in insured's duty to disclosure, see, Chapter 2 of this thesis.

Of course, the insurer is not required to disclose all that he knows. Instead, he is required to disclose those matters that the insured is ignorant of and unable to discover. It would appear that an important factor to decide whether one ought to impute knowledge to the insured so that the insurer's duty of disclosure can be waived is the full consideration of the facts and circumstances of each case. In general, considering the nature of the insured which is different from that of the insurer, it will be difficult to impute constructive knowledge to the insured. In conclusion, the insurer's duty of disclosure generally includes constructive knowledge in non-marine insurance cases as well as in marine insurance cases.⁶²

7.5. ANALYSIS OF INSURER'S LIABILITY IN NEGLIGENCE

7.5.1. AT FIRST INSTANCE

As to the insurer's duty of care owed to the insured, the trial judge, who relied on the view that the existence of a duty of care is consistent with the requirement of good faith and fair dealing which ought to govern the relations between the insured and the insurer, held that the insurers were liable to the insureds for the breach of the common law duty of care not to cause economic loss, and damages as to the lost further advances were awarded to the insured banks. In other words, he awarded damages to the insured in the tort of negligence as an alternative to damages in respect of a breach of the duty of utmost good faith, if the courts do not allow an action for damages for the insurer's non-disclosure. He objected to the view that this case was one of a pure omission, in respect of which a duty of care in negligence does not exist.

It would appear that the twin test of foreseeability and fairness for establishment of the duty of care was satisfied. On the facts, it was reasonably foreseeable by the insurers that there was a manifest and obvious risk that a failure to disclose would lead to financial

⁶²H. Yeo, "*Uberrima Fides* - Reciprocity of Duty in Insurance Contracts", (1988) 2 Review of International Business Law (No. 3) 271, at pp. 277-280

loss by the insured. In addition, it was held that in the special relationship existing between insured, broker and insurer, one could owe the other a duty to control the actions of a third party. Therefore, the duty of care could arise in this sense. It would appear that Steyn J's decision as to the insurer's duty to take care in business dealing with insured and broker is a landmark decision, creating a significant impact on the insurance market, although there are some debatable aspects in English common law.⁶³

7.5.2. HIGHER COURTS

The Court of Appeal considered two questions in relation to this issue - whether a breach of the duty of disclosure was itself a tort and whether the insurer was liable for negligence. The Court of Appeal rejected the first argument that a breach of the duty itself constitute a tort.⁶⁴ The Court of Appeal also held that the insurer did not owe the insured a common law duty of care in negligence after the analysis of the twin test of foreseeability and fairness. As far as the aspect of foreseeability is concerned, the Court of Appeal admitted that the economic loss suffered by the insured was a reasonably foreseeable consequence of the failure of an employee of the insurers.

However, as far as the question of whether it is just and reasonable to impose such a duty on the insurer is concerned, the Court of Appeal showed the negative view, based on the facts that the parties were in a contractual relationship, the loss was pure economic loss, and the alleged default was one of pure omission rather than commission. Of course, if there is a voluntary assumption of responsibility and a reliance on that assumption, there might be a duty of care even in this situation in particular in case of pure omissions. However, the Court of Appeal held that on the facts these two

⁶³[1987] 1 Lloyd's Rep. 69, at pp. 97-102 ; Also see, T. Scotford, "The Insurer's Duty of Utmost Good Faith Implications for Australian Insurers", (1988) 1 Ins. L.J. (No. 2) 1, at pp. 17-19

⁶⁴This argument is related to the issue of the remedy of damages. As to the reasons for denying of creation of a new tort, see, sub-chapter 7.7.2. which deals with the issue of damages.

requirements were not satisfied, saying that there was no clear evidence to accept that the defendants had assumed a responsibility in tort to speak and there was any reliance on the insurers by the insured in this regard.

The Court of Appeal thought that the mere fact that the insurer's conduct was morally or commercially blameworthy was not sufficient to establish a remedy in tort. In addition, it was held that a continuing existence of established business relationship between the insurer and the insured in an insurance contract which is a contract of utmost good faith was not enough to turn the insurer's pure omission into a misrepresentation in tort.⁶⁵ The Court of Appeal regarded imposition of such a duty in tort as a contradiction to the basic principle of the law of contract that there is no obligation to disclose a material fact during pre-contractual negotiations before entering into an ordinary commercial contract.

The House of Lords affirmed the view of the Court of Appeal that the insurer was not liable to the banks for the breach of the duty of care not to cause economic loss. Lord Templeman, with whom Lords Brandon and Ackner agreed, clearly objected to the insured's contention that a negotiating party owes a duty to disclose to the party opposite information that the agent of the party opposite had committed a breach of duty towards his principal in an earlier transaction. It would appear that the reasoning of the higher courts is that the rights of the insurer and the insured should be decided by the contract in question and by the principle of utmost good faith, and not by the law of tort.⁶⁶

7.5.3. CRITICISM

⁶⁵[1988] 2 Lloyd's Rep. 513, at pp. 562-566

⁶⁶See, *Tai Hing Ltd v. Liu Tong Hing Bank* [1986] A.C. 80

However, it might be possible to say that a duty of care in respect of economic loss or a pure omission could exist, considering the nature of the relationship between the insured and the insurer in insurance contracts. The contract of insurance is a contract of utmost good faith, therefore duty to speak is imposed on the parties, unlike an ordinary commercial contract. This nature might satisfy a prerequisite of creation of a duty of care, which is that there should be a special relationship between the parties. As Steyn J. at first instance had mentioned, the special relationship existing between insured, broker and insurer might lead to a view that one could owe the other a duty to control the actions of a third party. In this sense, the duty of care could arise. It is true that liability is not generally imposed on the parties by English tort law for a pure omission. However, if the omission is itself a clear breach of a duty to act, it might be possible to regard the insurer's failure to speak as an implied representation that there is nothing to disclose. Lord Jauncey in the *Skandia* case reserved his opinion on this matter, leaving a possibility of giving rise to duty of care.⁶⁷ It would appear that the crucial question of whether the nature of the duty of utmost good faith between the parties gives rise to the special relationship which is required for imposition of a tortious duty of care was left open.⁶⁸

7.6. THE ISSUE OF CAUSATION

7.6.1. JUDGMENTS OF THE COURTS

Both Steyn J. and the Court of Appeal thought that the fraud exclusion clause covered both the fraud of Ballestero and that of broker, therefore the broker's fraud had caused the insurer to reject the insured's claim on the policy. Based on this, it was held that the losses were caused by the failure of the insurer to disclose broker's fraud to the insured

⁶⁷[1990] 2 Lloyd's Rep. 377, at p. 389 ; Also see, *Ibid.*, at pp. 379-380 (Lord Bridge)

⁶⁸There are some cases in which new torts were created to give a remedy of damages. See, J. Birds, *Modern Insurance Law*, at p. 116, footnote 16

as well as by the fraud of Ballestero. In other words, the failure by Mr. Dungate to inform the insured of the fraud of Mr. Lee was also regarded as a causation of the insured's loss. Likewise, the insurer's breach of duty of disclosure was one of the two causes of equal efficacy.

However, in the House of Lords, their Lordships thought that the banks' loss was not caused by the insurer's non-disclosure of the dishonesty of the broker, but caused by Mr. Ballestero's fraud. On the issue of causation, Lord Templeman said ;

"... this argument confuses the cause of the advance and the cause of the loss of the advance. The cause of the advance was the fraud of Mr. Lee.... The fraud of Mr. Ballestero caused the loss of the advance and caused the rejection by the insurers of any claim under the policy.... The fraud of Mr. Lee which caused the advance to be made did not affect the rights of the banks to recover their loss and therefore did not cause the loss of the advance."⁶⁹

Based on this, the House of Lords held that the broker's fraud was not within the fraud exclusion clause, therefore the insurer could not have repudiated liability on the ground of the broker's fraud, and the insurer could not have been under any duty to disclose it to the insured. Consequently, it was held that the duty of utmost good faith owed by the insurer to the insured had not been breached in the circumstances, because they took the view that the broker's deceit had no connection with the banks' loss, although it was a consequence of broker's fraud that the advance of money was uninsured. Their Lordships said that the advance would have been lost whether or not it was insured, because the insurance policy contained a fraud exemption clause.

7.6.2. CRITICISM

According to the well established principle, the duty of disclosure operates irrespective of its connection to the loss in question. In other words, where the insured withholds a material fact, the insurer can avoid his liability even though the fact undisclosed did not

⁶⁹[1990] 2 Lloyd's Rep. 377, at p. 387

cause the loss in question. However, the House of Lords in the *Skandia* case held that the insurer's duty of utmost good faith had not been breached in the circumstances because their Lordships took the view that the broker's deceit had no connection with the banks' loss. It would appear that the House of Lords' reasoning is inconsistent with the traditional principle. The better view seems to be that if the insurer fails to disclose a material fact, he should not be allowed to plead that it did not cause the loss.

In addition, Lord Templeman's distinction between the cause of the advance and the cause of the loss of the advance seems to ignore the evidence advanced by the insured banks that if they had known of broker's fraud, they would not have continued to employ Notcutts, they would not have employed any other firm of insurance brokers, they would have broken off all dealings with Ballestero, and they would not have made further loans to him.⁷⁰ With this evidence, the Court of Appeal agreed with the trial judge that the non-disclosure by the insurer of the broker's fraud was a cause of the insured banks' losses. Based on this, it would appear that the conclusion of the House of Lords that the insurer's breach of duty was not a cause of the insured's losses is unacceptable.⁷¹

As a result of the House of Lords interpretation of the issue of causation, some important issues such as the duty of utmost good faith and the duty of care, which were deeply considered in the lower courts, were treated as something irrelevant in the House of Lords. In addition the hope that this case might encourage the insurers' commercial morality in carrying out their business seemed to have diminished.

7.7. DAMAGES FOR THE BREACH OF DUTY OF UTMOST GOOD FAITH

⁷⁰D. Allen, "Non-Disclosure: Hairshirt or Halo?", (1992) 55 M.L.R. 96, at p. 101

⁷¹For the other criticism of the House of Lords' decision on causation, see, F. Trindade, "The *Skandia* Case in the House of Lords", (1991) 107 L.Q.R. 24, at pp. 27-28

7.7.1. GENERAL CONSIDERATION AND STEYN J.'S DECISION

The Most controversial issue in the Skandia case is whether the insured banks could recover damages for the insurer's breach of duty of utmost good faith, or whether the remedy would be restricted to return of the premium with avoidance of the contract. It would appear that there had been only one case in which the issue of the remedy of damages for the breach of the duty of disclosure was discussed in the court before the Skandia case decided this issue. In Glasgow Assurance Corp. Ltd v. Symondson,⁷² Scrutton J. said that non-disclosure was not a breach of contract giving rise to a claim for damages, but a ground of avoiding a contract.⁷³ In cases of the insured's breach of the duty of utmost good faith, the insurer has the right of election to repudiate the contract, the contract becomes void *ab initio*, and premiums will be returned for total failure of consideration unless there is a fraudulent conduct. In most case, the avoidance of the contract is an adequate remedy for the insurer.⁷⁴ In this case, there is no real need to consider the right to damages.⁷⁵

Where the insured discovers the insurer's breach but no loss has yet occurred, it is possible to imagine for the insured to repudiate the contract in order to find other insurers who offer more favorable rates of the premium, although he may continue with the existing contract. However, where the breach of duty was committed by the insurer and the insured discovers the insurer's breach of duty after a loss has already occurred, return of the premium with the traditional remedy of avoidance would be a quite inadequate remedy for the insured, because the insured is much more concerned with

⁷²(1911) 16 Com. Cas. 109

⁷³*Ibid.*, at p. 121

⁷⁴However, from the insured's point of view, this so-called "all-or-nothing" approach is very harsh and it has been criticised. For more discussion, see, Chapters 9 & 10 of this thesis.

⁷⁵Arguably, there might be a possibility, unless it is a case of the insured's pure non-disclosure, that the insured relies on s. 2(2) of the Misrepresentation Act 1967, asking the court to award damages to the insurer instead of avoidance of the contract.

ensuring that his risks continue to be adequately covered. In this situation, what the insured wants to do is to elect to continue with the policy and to claim compensation under the cover. It would be quite anomalous that there should be no claim for damages for breach of the duty in a case where that is the only effective remedy.

In the *Skandia* case, the non-disclosure was found after the occurrence of the event insured against. Therefore, the traditional remedies - avoidance of the contract and the return of the premium - would be ineffective remedy for the insured. According to Steyn J., who focused on the principle *ubi jus ibi remedium* - there must be a real cure where there is an actual loss -, damages was awarded to the insured from an insurer as to the loss suffered by the insured as a result of a breach of obligation of the utmost good faith by the insurer. In other words, he held that the insurers, Hodge and Skandia, were vicariously liable to the insureds in damages - the same amount as the loans made by the insureds after Dungate (Hodge's employee until October 1, 1980, and thereafter Skandia's employee) knew of the fraud of Lee. It would appear that the damages awarded against the insurers were compensatory rather than punitive damages, considering that the concepts of bad faith claim and punitive damages are not prevalent in English law.⁷⁶ Likewise, according to Steyn J.'s view, apart from the traditional remedy of rescission of the contract, damages were awardable if damages are the only effective remedy for the insurer's breach of duty of disclosure.

7.7.2. HIGHER COURTS' OBJECTION TO AWARDING DAMAGES

The Court of Appeal discarded Steyn J's innovatory decision of awarding a remedy of damages, saying that a breach of the duty of disclosure did not give rise to a claim in damages because the duty of disclosure was neither contractual, tortious, fiduciary nor

⁷⁶A. Pincott, "Growing Pains: Two English Decisions on the Duty of Good Faith", (1988) 1 Ins.L.J. 27, at p. 34

statutory in character but this was found on the jurisdiction originally exercised by the court of equity to prevent imposition.

Slade L.J. in the Court of Appeal provided four particular reasons for rejecting of awarding a tort remedy in damages for the insurer's breach of the duty of utmost good faith.⁷⁷ Firstly, the power to grant relief for non-disclosure stems from the equitable jurisdiction to prevent imposition, from which also stems the power to grant rescission for undue influence or duress. Since duress and undue influence as such give rise to no claim for damages, there is no reason in principle why non-disclosure should sound in damages. Secondly, the right to avoid for non-disclosure could arise even where non-disclosure had not effect on the mind of the actual insured, but damages could not be awarded in this situation. Thirdly, ss. 17 to 20 of the M.I.A. 1906 made no mention of damages being available for the insured's non-disclosure. If Parliament had contemplated an award of damages as a remedy, it would surely have said so. Fourthly, the duty of disclosure is absolute. In other words, it can be breached innocently in the absence of fraud or negligence. Under this circumstance, to allow damages for breach could create great hardship for innocent insurers - and, even more likely, for innocent insureds. The House of Lords also took the same view with the Court of Appeal.

7.7.3. CRITICISM

It would appear that the Court of Appeal's reasons of rejecting of awarding damages are unacceptable. As to the first reason, the duty of utmost good faith originated in the common law courts of Lord Mansfield. In other words, it is a common law duty, not an equitable duty. Damages is the common law remedy. Based on this, in principle, there seems no convincing reason why damages should not be awarded to the insured for a breach of the insurer's common law duty of utmost good faith. As far as the second reason is concerned, this is substantially modified as a result of the House of Lords'

⁷⁷[1988] 2 Lloyd's Rep. 513, at pp. 547 and 550

decision in *Pan Atlantic Insurance Co. Ltd v. Pine Top Insurance Co. Ltd.*⁷⁸ which held that the additional element of the actual inducement was required in order to avoid the contract for non-disclosure. Steyn J. at first instance also said that where the insured's action was for damages, the test of materiality would become whether the actual insured was actually influenced by the insurer's breach of duty. In other words, Steyn J. insisted that the insured had to prove inducement before he could claim damages against the insurer for breach of duty.

As regarding the third reason, the M.I.A. 1906 was merely a codification of the law as it had developed as at a particular time. Therefore, the statement that "if Parliament had contemplated damages as a remedy it would surely have said so" is illogical and unacceptable. As to the fourth reason, although it seems to be somewhat convincing, the possible hardship which the insured might have would be relatively small, compared with his inability to recover for a loss that he has suffered and that he expected to be covered by the policy. Likewise, the Higher courts' reasoning for rejecting of awarding damages is simply unacceptable.

In the U.S.A., breach of good faith has been understood as a tort in the context of insurance. This interpretation is strongly related to the concept of bad faith with tort. For example, when the insurer mishandled the insured's claim, the courts allowed not only contractual damages but also extra contractual damages such as mental distress damages and economic consequential loss. In addition, if the insurer's behavior is intentionally malicious and oppressive, punitive damages may also be granted for a tort breach. In Australia, damages for the insurer's breach of good faith in dealing with the

⁷⁸[1994] 3 W.L.R. 677

plaintiff's claim was awarded by Badgery-Parker J. in Gibson v. The Parkes District Hospital.⁷⁹

Furthermore, it might be said that the relationship between the insurer and the insured is akin to a fiduciary relationship, considering the facts that mutual trust and confidence is regarded as a basis of insurance contracts, the duty of utmost good faith is mutual one between the parties, and it is a continuing duty.⁸⁰ In fact, the category of fiduciary relationship is not closed⁸¹, and this term of fiduciary relationship is very comprehensive and is used in a loose sense.⁸² In the U.S.A. the fiduciary relationship between the insurer and the insured, at least in liability insurance, has been widely recognized⁸³ and this tendency seems to extend to other kinds of insurance.⁸⁴ In a Canadian case, Plaza Fiberglass Manufacturing Ltd v. Cardinal Insurance Co.,⁸⁵ it was held that the duty of utmost good faith is fiduciary in nature, so that damages were awardable in equity for the insurer's breach. These innovatory interpretations will provide a valuable clue for the consideration of the possibility of recognition of remedy of damages for the insurer's breach of good faith in England. The original purpose of recognition of the nature of reciprocity of the duty of utmost good faith - equality and justice - will be only achieved and secured by providing an effective remedy. Steyn J.'s decision was surely a landmark

⁷⁹(1991) Australian Torts Rep. 81-140 ; Also see, a Canadian case, Dillon v. Guardiann Insurance Co. (1983) 2 C.C.L.I. 227 (Ont. H.C.) ; J. Fleming, "Insurer's Breach of Good Faith - A New Tort?", (1992) 108 L.Q.R. 357-359

⁸⁰J. Birds, *Modern Insurance Law*, (1993, 3rd ed.), Sweet & Maxwell, at p. 115, footnote 13 ; "Insurers not liable in damages for failure to disclose", [1988] J.B.L. 421, at p. 424

⁸¹English v. Dedham Vlae Properties Ltd [1978] 1 W.L.R. 93, at p. 110.

⁸²Re Reading's Petition of Right [1949] 2 All E.R. 68, at p. 70.

⁸³Crisci v. Security Insurance Co. 426 P.2d 173 (1967) (Calif. S.C.) ; Gruenberg v. Aetna Insurance Co. 510 P.2d. 1032 (1973) (Calif. S.C.) ; Florida Farm Bureau v. Rice 393 So.2d. 552 (1980) (Florida C.A.)

⁸⁴Egan v. Mutual of Omaha Insurance Co. 598 P.2d. 452 (1979) (Calif. S.C.) ; Hoskins v. Aetna Life Insurance Co., 452 N.E. 2d. 1315 (1983) (Ohio S.C.)

⁸⁵(1990) 68 D.L.R. (4th) 586

which is a realistic and positive decision, extending the scope of remedies available to the insured in the case of the insurer's breach of the duty of utmost good faith. His decision could be seen as a kind of an elimination of the so-called "all-or-nothing" approach.

7.8. ANALYSIS OF DECISIONS OF THE GOOD LUCK CASE⁸⁶

Hobhouse J. held that the bank was entitled to damages as to the amount of the further advance which was made as a result of the insurer's breach of the duty to speak deriving from the express terms of the letter of undertaking in failing to inform the bank that the mortgaged vessel had been or was in a prohibited area. He also admitted, as a basis of awarding damages, a general duty to disclose arising out of an implied term in the undertaking. He held that damages could be also awarded from negligence in breach of a duty of care. While he admitted that the duty of good faith was mutual and continued even after the conclusion of the contract, he held that the insurers did not owe the bank a duty of disclosure, because the insurer owed this duty of utmost good faith only to the insured, not to the assignee of the proceeds of the policy.⁸⁷

The Court of Appeal approved the reciprocity of the duty of utmost good faith and its continuation beyond the stage of the formation of the contract. They also agreed that the insurer had a duty of good faith to the insured, not to the assignee of the proceeds of the policy, therefore, the principle of utmost good faith did not arise in the relationship between the insurer and the bank.⁸⁸ The Court of Appeal overruled Hobhouse J.'s decision on the availability of damages for the breach of a duty to speak, because they

⁸⁶The main issues in the Good Luck case are mostly overlapped with those in the Skandia case. Therefore, this sub-chapter will very briefly discuss these issues. For the issue of the insurer's continuing duty of utmost good faith to the assignee of the proceeds of the policy, see, Chapter 8 of this thesis. For the other issue, see, the analysis of the Skandia case.

⁸⁷[1988] 1 Lloyd's Rep. 514, at p. 546

⁸⁸[1989] 2 Lloyd's Rep. 238, at pp. 261-264

had a different view on the issues of the duty to speak imposed on the insurer in the letter of undertaking and the negligence in tort, saying;

"In our opinion... the club was not under any duty to speak in the circumstances of this case, either under any express or implied terms of the letter of undertaking, or by virtue of the operation of any obligation to observe the utmost good faith in its relations with the bank."⁸⁹

This reasoning seemed to be related with the Court of Appeal's new construction of the letter of undertaking and a radical opinion about the effect of a warranty in an insurance policy. According to the traditional view of the effect of a breach of a warranty in a marine insurance, which was upheld by Hobhouse J. at first instance, the insurer is discharged from liability as from the date of the breach of warranty, i.e. automatic avoidance. However, the Court of Appeal held that in any event a breach of warranty did not automatically render a contract of insurance void, saying that s. 33(3) of the M.I.A. 1906 should be read as enacting the same rule as that which applies, in the absence of contrary agreement, to breach of express promissory warranties in the law of non-marine insurance.⁹⁰

In non-marine insurance, the effect of a breach of warranty is the same as that of a breach of condition in the general law of contract, that is to say, it gives to the innocent party the option to rescind. Therefore, the insurance is just voidable, not void.⁹¹ Consequently, the Court of Appeal held that the breach of the duty in the letter of undertaking by the shipping company did not render the Good Luck automatically uninsured and the insurer was not in a breach of the duty to report to the bank under the

⁸⁹Ibid., at p. 273.

⁹⁰Ibid., at p. 259

⁹¹Ibid., at pp. 253-259 ; See, *White & Carter (Councils) Ltd v. McGregor* [1962] A.C. 413, at p. 427 ; The 5th Report of the Law Reform Committee on Conditions and Exceptions in Insurance Policies, 1957, Cmnd. 62 at para. 8 ; The Law Commission's Report No. 104 on Non-Disclosure and Breach of Warranty, 1980, Cmnd. 8064, at paras. 6.2

letter of undertaking, because the insurer had eventually informed the bank of the fact when he had finally decided to reject the bank's claim.

The House of Lords reversed the decision of the Court of Appeal on the effect of the breach of a warranty in an insurance contract, regarding a warranty in a marine insurance as a condition precedent, saying;

"... it becomes readily understandable that, if a promissory warranty is not complied with, the insurer is discharged from liability as from the date of the breach of warranty."⁹²

In other words, the fulfillment of the promissory warranty was a condition precedent to the insurer's liability to cover the risk. Therefore, once the Good Luck entered into a prohibited area, she was uninsured. The insurer had ceased to insure the ship. As a result of this, the insurer should have given notice to the bank when he became aware that Good Luck had been trading in a prohibited zone at the time of the casualty. Consequently, the plaintiff was entitled to damages for the insurer's breach of the duty to speak to the bank embodied in the letter of undertaking (not based on the principle of utmost good faith).⁹³

⁹²[1991] 2 Lloyd's Rep. 191, at p. 202 ; See, *Thomson v. Weems* (1884) 9 App. Cas. 671 at p. 684

⁹³*Ibid.*, at pp. 203-205

CHAPTER 8. POST-CONTRACTUAL DUTY OF UTMOST GOOD FAITH

8.1. GENERAL CONSIDERATION

In the U.S.A., an implied covenant of good faith and fair dealing in every contract that neither party will do anything which will injure the right of the other to receive the benefits of the agreement has been prevalent and generally applied in practice in a positive way.¹ This tendency, i.e., the general recognition of the duty of good faith which is applied throughout the contract, has been well established in German law and French law. It would appear that this concept has been also recently developed in Australia and Canada.

In English contract law, however, the principle of the duty of good faith which is applied throughout the contract has been only narrowly and less positively applied in practice. In other words, although some attempts to adopt this principle have been made, the widely accepted current tendency in English contract law is different from the general recognition of this principle.

A recognition of so-called duty of co-operation is a good example of English contract law's approach to this principle. In *Southern Foundries Ltd v. Shirlaw*², Lord Atkin expressed a duty of co-operation in the light of a continuing duty of good faith in the general law of contract, saying that ;

"... a positive rule of the law of contract that conduct of either promisor or promisee which can be said to amount to himself 'of his motion' bringing about the impossibility of performance is in itself a breach."³

¹*Comunale v. Traders & General Ins.Co.* 328 P 2d 198, at p. 200 (Cal, 1958) ; Also see, *Kirke La Shelle Co. v. Paul Armstrong Co.* 263 N.Y. 79, at p. 87 (1933) ; *Beck v. Farmers Ins. Exchange* 701 P 2d 795 (Utha, 1985)

²[1940] A.C. 701

³*Ibid.*, at p. 717

In Nissho Iwai Petroleum Co. Inc. v. Cargill International S.A.⁴, Hobhouse J. also stated that ;

"Similarly, it is an implied term of a contract that one party shall not obstruct or prevent the other from performing the contract."⁵

This expression means that there is an implied term that neither party will do anything throughout the contract in question to cause a situation in which all or a part of the contract cannot be performed. This interpretation can be also understood as one of the attempts to adopt the above principle.

As regarding the continuing duty of utmost good faith in insurance contracts, it has been approved in England, although the question of the ambit of the duty, in particular in relation to the continuing duty of disclosure, is still debatable. For instance, Mathew L.J. in Boulton v. Houlder Brothers & Co.⁶ said that ;

"It is an essential condition of a policy of insurance that the underwriters shall be treated with good faith, not merely in reference to the inception of the risk, but in the steps taken to carry out the contract. That being the meaning of the contract, effect is given to it by means of the order for discovery of ship's papers, and the affidavit with relation to them."⁷

A series of recent English insurance cases has confirmed that the requirement of utmost good faith survives beyond the time of the formation of the policy, and continues throughout the contractual relationship.⁸ The concept of the continuing duty of good

⁴[1993] 1 Lloyd's Rep. 80

⁵Ibid., at p. 84 ; Also see, Stirling v. Maitland (1864) 5 B. & S. 840, at p. 852 ; Agrimpex Hungarian Trading Co. for Agricultural Products v. Sociedad Financiere De Bienes Raices S.A. (The Aello) [1960] 1 Lloyd's Rep. 623

⁶[1904] 1 K.B. 784

⁷Ibid, at pp. 791-792 ; Also see, Leon v. Casey [1932] 2 K.B. 576, at pp. 579-580

⁸Black King Shipping Corporation v. Massie (The Litsion Pride) [1985] 1 Lloyd's Rep. 437 ; Continental Illinois National Bank & Trust Co. of Chicago v. Alliance Assurance Co. Ltd (The Captain Panagos) [1986] 2 Lloyd's Rep. 470 ; La Banque Fianaciere v. Westgate Insurance Co. [1990] 2 Lloyd's Rep. 377 ; Bank of Nova Scotia v. Hellenic Mutual War Risks Association (Bermuda) Ltd (The Good Luck) [1988] 1 Lloyd's Rep. 514

faith in insurance contracts has also been recognized by the Australian courts and legislation. Section 13 of the Insurance Contracts Act 1984 confirms it, saying ;

"A contract of insurance is a contract based on the utmost good faith and there is implied in such a contract a provision requiring each party to it to act towards the other party, in respect of any matter arising under or in relation to it, with the utmost good faith."⁹

In addition, in *Trans-Pacific Ins. Co. (Australia) Ltd v. Grand Union Ins. Co. Ltd*¹⁰, Giles J. held that "the duty of good faith is not limited to the time of entry into the contract of insurance but subsists throughout the currency of that contract".¹¹ In fact, there is no doubt that, apart from the statutory recognition, it is an implied condition of every policy of insurance that the parties should observe good faith toward each other at all material times and in all material particulars.

8.2. AMBIT OF A CONTINUING DUTY OF UTMOST GOOD FAITH

Although the continuing nature of the duty of utmost good faith beyond the time of the formation of the insurance contracts is recognized in the statutes and in the courts, the scope of this concept is not clear. There have been two interpretations as to this question - a positive interpretation and a passive interpretation. One of the main criteria to distinguish two interpretations is to what extent the duty of disclosure in the post-contractual stage will be applied in practice.

8.2.1. POSITIVE (BROAD) INTERPRETATION

⁹Also see, s. 60(1)(a) and (b)

¹⁰(1989) 18 N.S.W.L.R. 675, at pp. 703-704

¹¹Also see, *Distillers-Bio-Chemicals (Australia) Pty Ltd v. Ajax Ins. Co. Ltd* (1973) 130 C.L.R. 1, at p. 31 ; *Dawson v. Monarch Ins. Co. Ltd* [1977] 1 N.Z.L.R. 372, at p. 378 ; *Deaves v. C.M.L. Fire & General Ins. Co. Ltd* (1979) 23 A.L.R. 539, at p. 580 ; *Sampson v. Gold Star Insurance Co. Ltd* [1980] 2 N.Z.L.R. 742, at p. 746 ; A. Tarr, "Dishonest Insurance Claims", (1988) 1 Ins. L.J. 42, at pp. 57-58

Prior to the decision in Black King Shipping Co. v. Massie (The Litsion Pride)¹² (hereafter *The Litsion Pride*), which has been regarded as a leading authority for the positive interpretation that the duty of utmost good faith including a positive continuing duty of disclosure is generally applied in practice beyond the formation of the contract, this duty had been only limitedly recognized in the context of claims and contractual terms where the insured failed to disclose relevant matters.

In *The Litsion Pride*, however, Hirst J. held that the duty of disclosure, which stems from the continuing nature of utmost good faith, generally continues even after the contract is concluded in relation to the matters which are relevant to the post-contractual stage where either party has an obligation, expressly or impliedly, to do something, or to say something or to abstain from doing something, or where one party enters into communication with the other whether in pursuance of a duty or not. In other words, according to the positive interpretation, the post-contractual duty of disclosure applies with their full vigor, and thus where the insured communicates with the insurer at any time after the formation of the contract, the insured has a general duty to disclose material fact. Hirst J. stated that ;

"... it seems to be manifest that, as part of the duty of utmost good faith, it must be incumbent on the insured to include within it all relevant information available to him at the time he gives it; and in any event the self-same duty required the assured to furnish to the insurer any further material information which he acquires subsequent to the initial notice as and when it comes to his knowledge, particularly if it is materially at variance with the information he originally gave."¹³

Hobhouse J. in *The Bank of Nova Scotia v. Hellenic Mutual War Risk Association (Bermuda) Ltd. (The Good Luck)*¹⁴ also expressed the similar view, saying ;

¹²[1985] 1 Lloyd's Rep. 437

¹³*Ibid.*, at p. 512

¹⁴[1988] 1 Lloyd's Rep. 514

"... there can be situations which arise subsequently where the duty of utmost good faith makes it necessary that there should be further disclosure because the relevant facts are relevant to the later stages of the contract... A fortiori, those considerations can also apply to contracts of insurance and a duty of disclosure which can exist under the continuing duty to show the utmost good faith. The duty is a continuing one."¹⁵

It would appear that the first basis for the general recognition of the continuing duty of disclosure after the formation of the insurance contract is s. 17 of the M.I.A. 1906. This section indicates that there will be a post-contractual duty of disclosure, since there is no specific restriction of the duty to pre-contractual stage in the wordings. Therefore, the duty of utmost good faith in s. 17 could persist throughout the entire contract. As to the relationship between s. 17 and ss. 18-20 of the M.I.A. 1906, the Court of Appeal in *C.T.I. v. Oceanus*¹⁶ clearly held that ss. 18-20 (non-disclosure and misrepresentation) were one aspect of the overriding duty of the utmost good faith in s. 17.¹⁷ Based on this, the advocates for the positive interpretation maintain that the application of the duty of disclosure in s. 18 should be interpreted in the light of s. 17 and consequently, the post-contractual duty of disclosure may exist.

Secondly, it would appear that the 'held covered' provisions of the Institute Clauses in a marine policy is another ground for the recognition of the continuing duty of disclosure.¹⁸ In case of deviation or change of voyage or any breach of warranty, the cover may still continue by the "held covered" clause provided notice be given to the

¹⁵Ibid., at pp. 545-546. ; Also see, *Phillips v. Foxall* (1872) L.R. 7 Q.B. 666 ; *Stag Line Ltd v. Tyne Shiprepair Group Ltd, The Zinnia* [1984] 2 Lloyd's Rep. 211 ; *Continental Illinois National Bank & Trust Co. of Chicago v. Alliance Assurance Co. Ltd (The Captain Panagos)* [1986] 2 Lloyd's Rep. 470

¹⁶[1984] 1 Lloyd's Rep. 476

¹⁷Ibid., at pp. 492 and 512 ; Also see, *Glicksman v. Lancashire & General Assurance* [1925] K.B. 593, at p. 609 and [1927] A.C. 139, at pp. 143-144

¹⁸Clause 10 of Institute Cargo Clauses (A)(B) and (C) ; Clause 3 of Institute Time Clauses (Hulls) ; Clause 2 of Institute Voyage Clauses (Hulls) ; Clause 2 of Institute War and Strikes Clauses (Hulls- Time and Hulls-Voyage) ; Clause 4 of Institute Time Clauses (Freight) ; Clause 3 of Institute Voyage Clauses (Freight) ; Clause 2 of Institute War and Strike Clauses (Freight-Time and Freight-Voyage)

underwriters immediately after receipt of advices and any amended terms of cover and any additional premium required by them be agreed. The assured seeking the benefit of this clause must give prompt notice to underwriters of his claim to be held covered as soon as he learns of the facts which render it necessary for him to rely upon the clause. The assured cannot take advantage of the clause unless he has acted in the utmost good faith. Likewise, the prerequisite for a 'held covered' clause is strongly related to the conduct based on the continuing duty of utmost good faith including the continuing duty of disclosure. McNair J., in *Overseas Commodities, Ltd v. Style*¹⁹, clearly expressed the relationship between the 'held covered' clause and the continuing duty of utmost good faith ;

"To obtain the protection of the 'held covered' clause, the assured must act with the utmost good faith towards the underwriters, this being an obligation which rests upon them throughout the currency of the policy."²⁰

Lastly, it would appear that the practice of ship's paper is also related to a continuing duty of utmost good faith. According to this practice, an underwriter is entitled at the earliest stage of an action on a policy of insurance to an affidavit of ship's papers. One of the reasons the Common Law Courts invented the order for ship's papers is a recognition of the plain fact that the underwriter is entitled to be treated with utmost good faith throughout the currency of the policy and the underwriter is entitled to get information from the insured as regarding all that has been done with reference to the subject-matter of the insurance.²¹ Scrutton L.J. in *Leon v. Casey*²² expressed the relationship between the practice of ship's papers and a continuing duty of utmost good faith, explaining the origin of the order for ship's papers ;

¹⁹[1958] 1 Lloyd's Rep. 546, at p. 559

²⁰Also see, *Liberian Insurance Agency Inc. v. Mosse* [1977] 2 Lloyd's Rep. 560, at p. 568

²¹*Harding v. Russel* [1905] 2 K.B. 83, at pp. 85-86

²²[1932] 2 K.B. 576, at pp. 579-580

"... and partly of the fact that insurance has always been regarded as a transaction requiring the utmost good faith between the parties, in which the assured is bound to communicate to the insurer every material fact within his knowledge not only at the inception of the risk, but at every subsequent stage while it continues, up to and including the time when he makes his claim, the Common Law Courts invented the order for ship's papers, an order which is made as soon as the writ is issued in an action on a policy of marine insurance."²³

With the above rationale, the advocates of the positive interpretation argue that the duty of disclosure which stems from the duty of utmost good faith is generally applied even after the formation of the contract. As to the ambit of the information which the insured should disclose to the insurer after the formation of the contract, the positive interpretation maintains that the post-contractual duty of disclosure will be related to the matters which affect the future conduct of the insurer under the policy such as the claims process. In relation to this issue, the proper test of materiality will be that a circumstance is material if non-disclosure of it would influence the prudent insurer's judgment in making the relevant decisions, at the post-contractual stage, such as the fixing of additional premium or a variety of decisions in relation to a claim, for instance, accepting, rejecting, or compromising a claim.

8.2.2. PASSIVE (NARROW) INTERPRETATION AND CRITICISM

This interpretation suggests that there is substantial differences in the scope of the duty of utmost good faith as it applies pre and post-contract, although the continuing nature of the duty of utmost good faith is recognized. According to this interpretation, once the contract is concluded, the duty of utmost good faith is no more than a duty to abstain from bad faith, whereas the duty of utmost good faith at the pre-contractual stage applies in its fullest amplitude. In other words, the duty of utmost good faith at the post-contractual stage is simply not to act fraudulently, either in supplying information under the terms of the contract or in the making of a claim on the policy. Therefore, general

²³Also see, *China Traders Insurance Co. Ltd v. Royal Exchange Assurance Corporation* [1898] 2 Q.B. 187, at pp. 192- 193 ; *Boulton v. Houlder Brothers and Co.* [1904] 1 K.B. 784, at pp. 791-792

application of the duty of disclosure at the post-contractual stage is not necessarily required. This interpretation seems to be related to the precedent that there is no duty to disclose material facts which arise after the contract is concluded. For example, in Lishman v. Northern Maritime Insurance Co.²⁴, Blackburn J. stated that ;

"... the obligation to disclose material facts does not ... extend to making it necessary to disclose facts after the underwriter is once bound in honor and so tempt him to break his engagement."

In addition, Lord Sumner in Commercial Union Assurance Co. v. Niger Co. Ltd²⁵ expressed his negative view of the continuing duty of disclosure beyond the formation of the contract, pointing out the absurd situation easily incurred as a result of the extending the duty to that stage ;

"The object of disclosure being to inform the underwriter's mind on matters immediately under his consideration, which reference to the taking or refusing of a risk then offered to him, I think it would be going beyond the principle to say that each and every change in an insurance contract creates an occasion on which a general disclosure becomes obligatory, merely because the altered contract is not the unaltered contract, and therefore the alteration is a transaction as the result of which a new contract of insurance comes into existence. This would turn what is an indispensable shield for the underwriter into an engine of oppression against the assured."²⁶

Likewise, according to the passive interpretation, the duty of utmost good faith at the post-contractual stage is simply not to act fraudulently and it does not necessarily include the duty of disclosure. The current practice of a duty of co-operation in a general contract, which has been recognized as one aspect of the continuing duty of good faith, might lend further weight to this passive interpretation. In England, a duty of co-operation has only applied in the case of absolute necessity and its application in practice seems to be less positive. This principle does not go so far as to require one

²⁴(1875) L.R. 10 C.P. 179, at pp. 182-183

²⁵(1922) 13 Ll.L.R. 75, at p. 82

²⁶Also see, Ibid., at p. 77 (Lord Buckmaster) and at p. 78 (Lord Atkinson) ; See, Cory v. Patton (1872) L.R. 7 Q.B. 304, at pp. 308-309 ; Pim v. Reid (1843) 6 M. & G. 1

party actually to perform positive acts to further the other's enjoyment. In other words, the purpose of this principle in England seems to have been restricted to prohibiting acts which harm the enjoyment of the other party, as the English law of contract does not require an high attention by one party to the other which amounts to absolute "good faith."²⁷ For instance, Devlin J. said in Mona Oil Equipment & Supply Co. Ltd v. Rhodesia Railways Ltd²⁸ ;

"It is, no doubt, true that every business contract depends for its smooth working on co-operation, but in the ordinary business contract, and apart, of course, from express terms, the law can enforce co-operation only in a limited degree - to the extent that is necessary to make the contract workable."

Likewise, once the contract is concluded, the contract is subject only to ordinary good faith.²⁹ This is the general common law position on this issue. In other words, there is no general duty to disclose material facts which occur during the period of insurance.³⁰ It would appear that this passive interpretation seems to be consistent with the test of materiality for the duty of disclosure in s. 18(2) which seems to preclude a post-contractual duty of disclosure, focusing on acceptance of the risk and fixing the premium.

The courts have not developed in detail the general principle of a post-contractual duty of disclosure applicable to the insured beyond the formation of the contract. It would

²⁷J. Burrows, "Contractual Co-operation and the Implied Term", (1968) 31 M.L.R. 390, at pp. 395-405

²⁸[1949] 2 All E.R. 1014, at p. 1018

²⁹Of course, this position may be changed by specific provisions in the contract. This issue will be discussed later.

³⁰Morrison v. Muspratt (1827) 4 Bing 60 ; British Equitable Insurance v. Great Western Railway Co. (1869) 20 L.T. 422 ; Iondies v. Pacific Fire and Marine Insurance Co. (1872) L.R. 7 Q.B. 517 ; Lishman v. Northern Maritime Insurance Co. (1875) L.R. 10 C.P. 179, at p. 182 ; Canning v. Farquhar (1886) 16 Q.B.D. 727, at p. 733 ; Re Marshall and Scottish Employers' Liability and General Insurance Co. (1901) 85 L.T. 757 ; Hadenfayre Ltd v. British National Insurance Society Ltd [1984] 2 Lloyd's Rep. 393, at p. 398 ; Container Transport International Ins. v. Oceanus Mutual Underwriting Association (Bermuda) Ltd [1984] 1 Lloyd's Rep. 476, at p. 486

appear that the application of the duty of utmost good faith beyond the time of the formation of the policy will be made only in exceptional cases. In *La Banque Financiere de la Cite S.A. v. Westgate Insurance Co. Ltd.*³¹ Lord Jauncey, in relation to the reciprocity of the duty of disclosure, limited the insurer's obligation to disclose material facts to the pre-contractual context, referring to the examples of the "arrived ship" or "demolished house" by linking the insurer's duty of disclosure and the facts which would reduce the risk.

He expressed the restrictive view as to the operation of the continuing duty of utmost good faith after conclusion of the contract, saying that ;

"There is, in general, no obligation to disclose supervening facts which come to the knowledge to either party after conclusion of the contract, subject always to such exceptional cases as a ship entering a war zone or an insured failing to disclose all facts relevant to a claim."³²

In other words, even though the concept of the continuing duty of disclosure is recognized, it may be imposed on the insured only in exceptional and limited cases which are related to the express terms of the insurance policy by which the insured is required to disclose to the insurer further information after the formation of the contract, or which are related to the claim process. In practice, a promissory warranty, in particular in fire insurance, may impose a duty on the insured to disclose facts occurring during the insurance which substantially increase the risk. However, even though a duty of disclosure may be imposed during the period of insurance by this practice, its nature is different from that imposed as a result of the principle of utmost good faith. In addition, the duty of disclosure which stems from the 'held covered clause' can be also interpreted as a duty from the contractual term between the parties.

³¹[1990] 2 Lloyd's Rep. 377

³²Ibid., at p. 389

It would appear that the issues in *The Litsion Pride* were based on the contractual term requiring the insured to give notice to the insurer of some relevant facts in relation to the rearrangement of the premium in the policy after the contract was concluded. It was a contractual duty to give notice in essence, and it had to be discharged with utmost good faith. In other words, the duty of utmost good faith was applied to the discharge of the insured's duty to advise the insurer of the relevant facts. Therefore, *The Litsion Pride* does not seem to be the authority to show whether or not the continuing duty of disclosure as a common law rule is actually applied in practice. The continuing duty of disclosure should not be recognized as a common law rule. It is more concerned with a contractual duty which stems from the particular terms in the policy.³³

This interpretation was supported in *New Medical Defence Union Ltd v. Transport Industries Ins. Co. Ltd*³⁴. In this case, the insurer argued that the insured was in breach of the duty of utmost good faith because he did not disclose a fact during the period of cover that would have been relevant to decisions that the insurer might have made during the contract. Rogers J. stated that, although the duty of utmost good faith could continue even after the contract was concluded, it did not impose on the insured a general post-contractual duty of disclosure. He also said that where an insurance policy did not impose upon the insured any duty, to which the continuing duty of good faith could be attached, to supply information, there was no breach of the continuing duty of good faith arising out of the insured's failure to volunteer to the insurer relevant information during the term of the insurance.³⁵ Based on this, Rogers J. rejected the insurer's argument. This decision clearly shows that, although there is a continuing duty of the utmost good faith, the application of the continuing duty of disclosure, which stems from the duty of utmost good faith, should not be generally extended beyond the

³³*Trans-Pacific Insurance Co. (Australia) Ltd v. Grand Union Insurance Co. Ltd* (1989) 18 N.S.W.L.R. 675, at p. 704

³⁴(1985) 4 N.S.W.L.R. 107

³⁵*Ibid.*, at pp. 111-112

formation of the contract. The continuing nature of the duty of disclosure should be limited to the discharge by the insured of his obligation under the contract.

In addition, as to s. 17 of the M.I.A. 1906 which is regarded as one of strong grounds for the positive interpretation, it might be possible to construe the meaning of this section in a different way. There is no doubt that there is no time limit for the principle of utmost good faith in the wordings in s. 17, and thus it persists beyond the formation of the contract. However, s. 17 is placed under the heading of 'Disclosure and Representation'. At common law, it is widely accepted that there is a time limitation in relation to the application of the duty of disclosure. Considering the fact that one of the functions of the heading in the statute is to delimit a boundary line of the following sections, it might be possible to say that the application of the duty of disclosure which stems from the principle in s. 17 is limited in accordance with the application of the duty of disclosure in s. 18 where there is a time limit i.e., the duty must be made up to the moment when the contract is concluded. In other words, considering s. 17's location in the M.I.A. 1906, the general application of the continuing duty of disclosure beyond the formation of the contract, which is one aspect of the broader concept of the duty of utmost good faith, might be restricted under the heading of "Disclosure and Representation" and might need harmony with other sections under the same heading.³⁶ Therefore, in this sense, it might be said that s. 17 cannot be the strong ground for the general recognition of the continuing duty of disclosure beyond the formation of the contract. Based on the above analyses, the passive (narrow) interpretation seems to be more convincing.

As to the effect of the breach of continuing duty of utmost good faith, *La Banque Fianaciere v. Westgate Insurance Co.*³⁷ held that any breach of this duty gives rise to

³⁶Ivamy, at p. 137

³⁷[1988] 2 Lloyd's Rep. 513

rescission and restitution of premium only, rejecting the possibility of awarding damages. This case particularly deals with the issue of breach of the insurer's duty of utmost good faith to the insured after the formation of the contract. Considering the fact that any breach of this duty is mostly found after a loss has occurred, insured's right to rescind the policy without recovery of damages will not be an effective remedy. A Canadian case, which also dealt with the insurer's continuing duty of disclosure in the claims process, justified awarding damages to the insured by way of classifying the relationship between the insured and the insurer as a fiduciary relationship.³⁸ This approach could provide a new idea as to the issue of the possibility of awarding remedy of damages, although it might have been regarded as an unorthodox way from the English insurance contract law's point of view.

8.3. DUTY OF UTMOST GOOD FAITH IN CLAIMS PROCESS

8.3.1. GENERAL CONSIDERATIONS

Some recent judgments, which clearly show that the duty of utmost good faith continues throughout the currency of the policy, recognized the duty of utmost good faith in the claim process. In other words, the duty of utmost good faith applies when the insured claims insurance money. For instance, in *The Litsion Pride* where the insured did not disclose deliberately to the insurer that the insured vessel had entered into a war zone without the requisite notice to the insurer in relation to a claim, it was held that the insurer could avoid the policy for breach of the continuing duty of utmost good faith, because the insured withheld details of his own breaches of the policy terms which have eventually contributed to the loss. In *Continental Illinois National Bank of Chicago v. Alliance Assurance Co. Ltd (The Captain Panagos)*³⁹, Evans J. also held that the

³⁸*Plaza Fiberglass Manufacturing Ltd v. Cardinal Insurance Co.* 68 D.L.R. (4th) 586 (1990)

³⁹[1986] 2 Lloyd's Rep. 470

insured should disclose the facts of previous fraudulent attempts to demolish the subject matter in the policy when a claim was made by the insured.⁴⁰

Likewise, the continuing duty of utmost good faith in the claims procedure in insurance contracts has been widely recognized. It would appear that, although the general recognition of the duty of disclosure after the formation of the contract is still very much controversial, the duty of disclosure in the claim process is far less debatable. In other words, although the courts have not developed any general concept of the insured's post-contractual duty of disclosure, they have recognized that the insured has a duty to disclose to the insurer all material facts surrounding the claim in the claim process. In fact, the duty of utmost good faith in the claim procedures is a good example of the insured's duty to act with the utmost good faith which continues beyond the conclusion of the contract. Accordingly, the claim must be honestly made and the insured must not hold back all material facts surrounding the claim in question.⁴¹ The principle of the reciprocity of the duty of utmost good faith in the claim process requires an insurer to react reasonably and fairly to a claim made by the insured in insurance contracts. For instance, there is a duty not to take a long time to settle the claim and a duty to disclose the adjusters' reports to the claimant. In addition, the duty to insist on a full and searching investigation into the case where there are circumstances of suspicion is imposed on the insurers to the public and to their shareholders, if they are a company.⁴² Likewise, the insurer has a duty to disclose to the insured all facts which would influence the judgment of the prudent insured in deciding whether or not to compromise the claim or to issue proceedings.⁴³

⁴⁰Also see, Bucks Printing Press Ltd v. Prudential Assurance Co. (1991, unreported)

⁴¹Shepherd v. Chewter (1808) 1 Camp. 274, at p. 275

⁴²Chapman v. Pole (1870) 22 L.T. 306, at p. 307

⁴³A. Pincott, "Growing Pains: Two English Decisions on the Duty of Good Faith" (1988) 1 Ins. L. J. 27, at pp. 33-34

8.3.2. SCOPE OF BREACH OF DUTY IN CLAIM PROCESS

There is no doubt that the making of a fraudulent claim under the policy is a breach of the duty of utmost good faith allowing the insurer to refuse the claim or to avoid the contract.⁴⁴ Does this principle extend to a reckless non-disclosure in the claims? According to the traditional view, the making of a fraudulent claim was a sufficient breach of the duty. However, in *The Litsion Pride*, Hirst J. extended the ambit of the duty of utmost good faith in the claims context, saying ;

"... in contrast to the pre-contract situation, the precise ambit of the duty in the claims context has not been developed by the authorities... It must be right, I think, by comparison with the *Style* and *Liberian* cases, to go so far as to hold that the duty in the claims sphere extends to culpable misrepresentation or non-disclosure."⁴⁵

This passage means that the scope of breach of the continuing duty of utmost good faith in the claim procedure might include the case where there is a culpable misrepresentation or non-disclosure of a material fact. In other words, if the insured completely disregards the truth of the material fact when he discloses material information in support of a claim, it is also a breach of the duty. Two recent cases, *Bucks Printing Press Ltd v. Prudential Assurance Co.*⁴⁶ and *Re Ontario Securities Commission and Osler Inc.*⁴⁷, indicated that fraud was not a necessary requirement, saying that recklessness on the insured's part was enough for the breach of the duty of utmost good faith.

It would appear that Hirst J.'s reasoning is based on the nature of the concept of utmost good faith. As a matter of general principle, the breach of the duty of utmost good faith

⁴⁴*Ewer v. National Employers Mutual General Insurance Association* [1937] 2 All E.R. 247 ; *Piermay Shipping Co. S.A. & Brandt's Ltd v. Chester (The Michael)* [1979] 1 Lloyd's Rep. 55

⁴⁵[1985] 1 Lloyd's Rep. 437, at p. 512

⁴⁶(1991, unreported.)

⁴⁷(1991) 82 D.L.R. (4th) 599

does not depend upon fraud. It surely includes the insured's negligent or reckless non-disclosure of the circumstances which would influence the prudent insurer's decision to accept, reject or compromise the claim in question. Considering the fact that reasonableness or prudence is a standard in relation to the duty of disclosure, it would appear that the extension of the scope of breach of the duty to the reckless or negligent non-disclosure is understandable.

However, it is as yet uncertain whether or not the duty to disclose all material facts surrounding the claim will operate beyond the general requirement that the insured must refrain from fraud or recklessness. One remaining question is whether the duty of utmost good faith entitles the insurer to reject the claim on the grounds of the insured's innocent non-disclosure of a material fact without fraud or negligence in the claims context. Hirst J. in *The Litsion Pride* did not discuss this issue. A possible answer is that, considering the fact that the degree of disclosure which is required in a claims process is different from that at the formation of the contract, the insured's innocent non-disclosure in the claims process does not defeat a claim. The extension of the insurer's right to innocent non-disclosure is undoubtedly too heavy burden to the insured and is unjustified.⁴⁸ This view seems to be supported by *Re Ontario Securities Commission and Osler Inc.*⁴⁹ and *Bucks Printing Press Ltd v. Prudential Assurance Co.*⁵⁰, which only referred to fraudulent and reckless non-disclosure in relation to the breach of the duty in the claim process.

8.3.3. EFFECT OF BREACH OF DUTY IN CLAIM PROCESS

⁴⁸Merkin & McGee, at A.5.2-08 ; M. Clarke, at p. 708

⁴⁹(1991) 82 D.L.R. (4th) 599

⁵⁰(1991, unreported.)

The submission of a fraudulent claim is a breach of the continuing duty of utmost good faith. In practice, an express condition is usually inserted in the policy to the effect that if the claim is fraudulent, the benefit under the policy is to be forfeited.⁵¹ In Britton v. Royal Insurance Co.⁵², Willes J. stated that ;

"The law is that a person who has made such a fraudulent claim could not be permitted to recover at all. The contract of insurance is one of perfect good faith on both sides, and it is most important that such good faith should be maintained. It is the common practice to insert in fire-policies conditions that they shall be void in the event of a fraudulent claim ; ... It would be most dangerous to permit parties to practice such frauds and then, notwithstanding their falsehood and fraud, recover the real value of the goods consumed."⁵³

At common law, the obligation not to submit a fraudulent claim or not to make claims in breach of the duty of utmost good faith has been regarded as an implied term in the policy.⁵⁴ If the insured submits a claim in which material facts relating to the extent or amount of the loss or relating to the circumstances of the loss have been fraudulently omitted, the insurer has the right to terminate the contract for the breach of the duty of utmost good faith, or he has the right to reject the claim in question, affirming the policy.

In other words, if the insured submits a fraudulent claim, the whole contract, and not just the particular claim which was fraudulently made, is avoidable, if it is the insurer's wish. Even in the absence of any express term as to the fraudulent claim in the policy, the insured who made a fraudulent claim cannot be protected as a result of the implied

⁵¹Harris v. Evans (1924) 19 Ll.L.R. 303 ; Central Bank of India Ltd v. Guardian Assurance Co. and Rustomji (1936) 54 Ll.L.R. 247

⁵²(1866) 4 F. & F. 905, at p. 909

⁵³Also see, Thurtell v. Beaumont (1823) 1 Bing. 339 ; Goulstone v. Royal Insurance Co. (1858) 1 F. & F. 276, at p. 279 ; McKirby v. North British Insurance Co. (1858) 20 Dunl (Ct of Sess) 463 ; Baker Welford and Otter-Barry, *The Law Relating to Fire Insurance*, (4th ed., 1948), at p. 289

⁵⁴See, Britton v. Royal Insurance Co. (1866) 4 F. & F. 905, at p. 909 ; Black King Shipping Co. v. Massie, The Litsion Pride [1985] 1 Lloyd's Rep. 437, at pp. 518-519 ; M. Clarke, at pp. 715-716 ; Merkin & McGee, at C.1.3.-01

term in the policy. It is not important whether the insured's fraud affects the whole or only part of the claim.⁵⁵

One question of whether the effect of 'avoidance' runs *ab initio* or from the date of the breach of the duty still remains. In practice, a special fraudulent claim clause which gives the insurer the right to repudiate the policy from the date of breach is often inserted in insurance policies, particularly in fire policies. From this clause, it is clear that the prior honest claims which have been already settled and paid by the insurer are not affected by the insurer's repudiation of the contract. Therefore, as far as the prior honest claims are concerned, they can be protected, if avoidance operates from the date of the breach of the duty.

However, Hirst J. in *The Litsion Pride* expressed a different view. He held that the submission of a fraudulent claim was a breach of a general duty of utmost good faith in s. 17 of the M.I.A. 1906 which shows that the duty of utmost good faith continues throughout the currency of the policy. As to the meaning of the word "avoid" in that section, Hirst J. stated ;

"In my judgment, "avoidance" in s. 17 means avoidance *ab initio*. Certainly this is the case in relation to pre-contract avoidance ..., and I see no reason for putting a different meaning on the word in relation to post-contractual events..."⁵⁶

Therefore, according to his reasoning, the insurer is entitled to avoid the whole contract *ab initio* for a fraudulent claim, if it is his wish.⁵⁷ If his interpretation is adopted, it means that the law regards the policy in question as never having existed. Therefore, it

⁵⁵*Britton v. Royal Insurance Co.* (1866) 4 F. & F. 905 ; *Lek v. Mathews* (1927) 29 Ll.L.R. 141

⁵⁶[1985] 1 Lloyd's Rep. 437, at p. 515 ; Also see, *Continental Illinois National Bank of Chicago v. Alliance Insurance Co. Ltd (The Captain Panagos)* [1986] 2 Lloyd's Rep. 470

⁵⁷Obviously, s. 17 of the M.I.A. 1906 provides that the policy *may* be avoided, not that it *must* be avoided. Therefore, the insurer is not bound to avoid the whole contract for a fraudulent claim.

would prevent the insured from recovering for a previously unsettled claim under the policy.⁵⁸ In addition, it may deprive the insured of the benefit of all previously settled claims.⁵⁹ Consequently, the previous losses which the insured honestly suffers may not be protected by the policy under this interpretation.

However, it would appear that Hirst J's decision on this issue seems to be incompatible with his interpretation as to the nature of the duty not to submit a fraudulent claim. Hirst J. said ;

"I am prepared to hold that the duty not to make fraudulent claims and not to make claims in breach of the duty of utmost good faith is an implied term of the policy, since I prefer the authority of *Blackburn v. Vigors* in the Court of Appeal to the obiter dicta in the *Merchants & Manufacturers* case."⁶⁰

In other words, Hirst J. regarded the duty not to submit a fraudulent claim as an implied term in the policy. In general, the effect of the breach of an implied term of the policy, like a breach of condition, is repudiation of the policy from the date of breach, not avoidance *ab initio*. Therefore, his two decisions seems to be inconsistent with each other. Clearly, Hirst J.'s decision as to the right to avoid the policy *ab initio* for a fraudulent claim seems to be too harsh to the insured.⁶¹ In *Gore Mutual Insurance Co. v. Bifford*⁶², the Canadian court held that the insurers were entitled to terminate the contract from the date of breach where a fraudulent claim was made. In practice, it is rare for the insurer to set up a defence relying on a breach of the implied duty of utmost good faith in the claims procedure, since the insurance policies, in particular the fire

⁵⁸Merkin & McGee, at A.5.2-07

⁵⁹*Magee v. Pennine Insurance Co. Ltd* [1969] 2 Q.B. 507

⁶⁰[1985] 1 Lloyd's Rep. 437, at pp. 518-519 ; Also see, Merkin & McGee, at C.1.3.-04

⁶¹*Johnson v. Agnew* [1980] A.C. 367 ; Also see, M. Clarke, at pp. 715-716 ;

⁶²(1988) 45 D.L.R. (4th) 763, at p. 765

policies usually include an express term that the insurer is entitled to repudiate the policy for a fraudulent claim from the date of breach.

As to the remedy for the insurer who has already paid out the money for the insured's claim which later turned out to be a fraudulent one, the insurer is entitled to recover the money he has paid. As to the extra money the insurer has spent to investigate the claim to decide whether or not it is a fraudulent one, the prevailing view is that the insurer is not allowed to recover the money as damages for breach of contract.⁶³ However, there might be a possibility to bring an action in the tort of deceit against the insured as regarding the question of awarding damages in fraudulent claims in insurance contracts.⁶⁴

8.4. CONTINUING DUTY OF GOOD FAITH TO THIRD PARTY

The courts in *La Banque Financiere v. Westgate Insurance*⁶⁵ and *Bank of Nova Scotia v. Hellenic Mutual War Risks Association (Bermuda) Ltd (The Good Luck)*⁶⁶ held that the insurer owed a continuing duty of utmost good faith to the insured. Does an insurer, then, owe a duty of utmost good faith to the third parties who have interests concerning the validity of the insurance policy? The courts in *Bank of Nova Scotia v. Hellenic Mutual War Risks Association (Bermuda) Ltd (The Good Luck)* held that the insurer owed the continuing duty of utmost good faith only to the insured, not to the assignee of the proceeds of the policy, even though the assignee of the proceeds of the policy has interests in the validity of the cover given by the insurer to the insured.

⁶³*London Assurance v. Clare* (1937) 57 Ll.L.R. 254 ; *La Banque Financiere de la Cite S.A. v. Westgate Insurance Co. Ltd* [1988] 2 Lloyd's Rep. 513 ; S. 2(2) of the Misrepresentation Act 1967 which stipulates the discretion to award damages does not apply to the breach of the duty to disclose material fact.

⁶⁴*London Assurance v. Clare* (1937) 57 Ll.L.R. 254, at p. 270

⁶⁵[1990] 2 Lloyd's Rep. 377

⁶⁶[1991] 2 Lloyd's Rep. 191

The reason is that an assignment of the proceeds of an insurance policy, i.e., an assignment of the right to recover under an insurance policy, does not make a new contract between the assignee and the insurer. Therefore, the assignor still remains as an insured in the insurance policy in question. As to this issue, Hobhouse, J., at first instance, said;

"The duty of the utmost good faith is an incident of the contract of insurance. It is mutual. The assignee of the benefit of such a contract does not initially owe any duty of the utmost good faith to the insurer, nor on the basis of mutuality is there, initially, any duty owed by the insurer to the assignee. The insurer's duty is to the shipowner, and if that duty is broken as against the shipowner, the assignee can have the benefit of the rights and remedies that arise from such a breach. The rights of the assignee can only arise from obligations to the assignor."⁶⁷

On the contrary, the duty to speak from the letter of undertaking, which was issued by the insurer to assist the assignee in this case is a different one. By this letter of undertaking, the insurer undertakes to inform the assignee in the event that the policy ceases. The courts held that the insurer had a duty to speak from the letter of undertaking to the third party, as this promise is a part of the contract which is enforceable against the insurer. In other words, a contractual duty to speak is imposed on the insurer to the third party by the letter of undertaking, and this duty is different from the duty of utmost good faith in essence.

⁶⁷[1988] 1 Lloyd's Rep. 514, at p. 546 ; Also see, [1989] 2 Lloyd's Rep. 238, at p. 264

CHAPTER 9. REVIEW OF ATTEMPTED REFORM

9.1. INTRODUCTION

It is evident that the duty of disclosure imposed on the insured in the making of insurance contract is defective¹, and it is strict in nature. The insured may be ignorant of the existence of the duty of disclosure, particularly in the case of renewal. The insured may not know exactly what information he should disclose to the insurer under the current test of materiality along with the prudent insurer test. The insured should disclose material facts within his constructive knowledge as well as his actual knowledge. According to the current test of materiality, a fact which the insured, however honest and careful, would not necessarily regard as something material which should be disclosed could be material to the insurers. This technical defence of non-disclosure is frequently used by the insurer where he has other defences to repudiate the claim, which may be more difficult for him to prove. In general, it would appear that the duty of disclosure has been extended beyond the scope of good faith and fair dealing which are believed to be the original purpose of this principle. Likewise, the current duty of disclosure has been interpreted and applied unduly in favour of the insurer.

Over the past few years, a great deal of criticism of the unfair and biased interpretation and practice of the duty of disclosure has been made by some judges², academic

¹The Law Commission' Report No. 104 on Insurance Law - Non disclosure and Breach of Warranty, Cmnd. 8064 (1980), at para. 10.5

²*Glicksman v. Lancashire and General Assurance Co. Ltd* [1927] A.C. 139, at pp. 143-144 ; *Provincial Insurance Co. v. Morgan* [1932] A.C. 240, at p. 252 ; *Lambert v. Co-operative Insurance Society* [1975] 2 Lloyd's Rep. 485, at pp. 491, 492 and 493 ; *Pan Atlantic Ins. Co. v. Pine Top Ins. Co.* [1993] 1 Lloyd's Rep. 496, at p. 508

literature³ and law reform bodies⁴. Although some legislation such as the Life Assurance Companies Act 1870, the Insurance Companies Act 1982, the Policyholder Protection Act 1975 and the Insurance Brokers (Registration) Act 1977 have been passed, these acts do not meet the urgent requirement of reform concerning the duty of disclosure in insurance contracts. Insurance law has escaped major legislative reform for a long time, because, firstly, governments have dealt with the issue of reform for the duty of disclosure in a passive and negative way and secondly, the lobbies of the insurance companies are effective and powerful enough to persuade governments to give up their intention to change the relevant statutes as to issue of the duty of disclosure. However, the publication of the proposed E.E.C. Directive in 1977⁵ dealing with major changes in insurance contract law, prompted governments' attention to the issue of reform in insurance contract law, in particular the duty of disclosure. In addition, the insurance

³J. Birds, "The Reform of Insurance Law" [1982] J.B.L. 449 ; "What is a Cover-Note Worth?", (1977) 40 M.L.R. 79 ; "Warranties in Insurance Proposal Forms", [1977] J.B.L. 231 ; R. Hodgkin, "Insurance law reform", [1981] L.M.C.L.Q. 284 ; B. Harnett, "The Doctrine of Concealment : A Remnant in the Law of Insurance" (1950) 15 Law and Contemp. Prob. 391 ; F. Achampong, "Uberrima Fides in English and American Insurance Law : A Comparative Analysis" (1987) 36 I.C.L.Q. 329 ; H. Yeo, "Uberrima Fides - Reciprocity of Duty in Insurance Contracts", (1988) 2 Review of International Business Law 271 ; "Of reciprocity and remedies - duty of disclosure in insurance contracts", (1991) 11 Legal Studies 131 ; A. Diamond, "The Law of Marine Insurance - has it a future?", [1986] L.M.C.L.Q. 25 ; H. Brooke, "Materiality in insurance contracts", [1985] L.M.C.L.Q. 437 ; R. Merkin, "Uberrimae Fidei Strikes Again", (1976) 39 M.L.R. 478 ; "Insurance law and the Law Commission", [1981] L.M.C.L.Q. 347 ; R. Hasson, "Uberrima Fides in Insurance Law - A Critical Evaluation" (1969) 32 M.L.R. 617 ; "The Special Nature of the Insurance Contract : "The Basis of the Contract Clause in Insurance Law", (1971) 34 M.L.R. 29 ; "Misrepresentation and Non-Disclosure in Life Insurance - Some Steps Forward", (1975) 38 M.L.R. 89 ; "A Comparison of the American and English Law of Insurance" (1984) 47 M.L.R. 505 ; "Good Faith in contract Law - Some Lessons from Insurance Law" (1987-1988) 13 Can. Bus. L.J. 93

⁴The Fifth Report of the Law Reform Committee - Conditions and Exceptions in Insurance Policies, Cmnd. 62, (1957) ; The proposed E.E.C. Directive - The directive on the co-ordination of the legislative, statutory and administrative provisions governing insurance contracts. (1977) ; The Law Commission's Working Paper No. 73, "Insurance Law - Non-disclosure and Breach of Warranty" (1979) ; The Law Commission's Report No. 104, " Insurance Law : Non-disclosure and Breach of Warranty" Cmnd. 8064 (1980)

⁵The full title : "The directive on the co-ordination of the legislative, statutory and administrative provisions governing insurance contracts".

industry made a quick response to the changing situation by issuing Codes of Practice as a self-regulation to mitigate some defects in this area in insurance contracts.

9.2. THE 5TH REPORT OF THE LAW REFORM COMMITTEE⁶

In 1957, the 5th Committee Report was published after considering the effect and practice of the duty of disclosure of material facts. The Committee expressed the view that the state of law as to the duty of disclosure was capable of leading to abuse in the sense that a variety of circumstances may entitle the insurers to repudiate liability against an honest and at least reasonably careful insured on purely technical grounds, and in fact such abuses had often occurred.⁷ Relying on the above consideration as to the duty of disclosure, the Committee formulated some provisions which in their view could be introduced into the law without legal difficulties arising from their application. The 5th Committee Report introduced the 'reasonable insured test' as a standard in relation to the test of materiality in the duty of disclosure. It also limited the scope of the duty of disclosure to the best of the insured's knowledge and belief.⁸ It would appear that these two provisions are appropriate attempts to change the current state of the law, considering the harshness and unfairness which the insureds have experienced as a result of the current test of materiality along with the prudent insurer test and the wide scope of the duty of disclosure which covers both the insured's actual and constructive knowledge.

However, the Committee made no formal recommendations for reform of the law as to the duty of disclosure. The Committee was of the view that the mere fact that an aspect of the law was theoretically open to criticism and might lead to abuses in practice did not justify a recommendation that it should be changed. The Committee was more

⁶(Conditions and Exceptions in Insurance Policies), Cmnd. 62, (1957)

⁷Ibid., at paras. 4 and 11

⁸Ibid., at para. 14

concerned about the possibility of interference with the liberty of contract of the parties by introducing any proposal to alleviate the insured's position.⁹ In other words, the Committee did not regard the issue of reform as urgent, and consequently the 5th Report of the Law Reform Committee failed to produce legislative response.¹⁰

9.3. THE LAW COMMISSION'S WORKING PAPER NO. 73

The Law Commission's Working Paper No. 73 entitled "Insurance Law - Non-disclosure and Breach of Warranty" which included provisional recommendations for reform of the law as to the issue of non-disclosure was published in 1979 in response to the proposed E.E.C. Directive in 1977 which called for major changes in insurance contract law in the U.K. The Law Commission clearly rejected the proposed E.E.C Directive. Instead, the government sought to change domestic laws to meet the demands of the proposed E.E.C. Directive and to avoid implementation of it in this country. In fact, five aspects of insurance law were referred to the Law Commission - non-disclosure by the insured, breach of warranty by the insured, misrepresentation by the insured, terms and exclusions in policies and increase and decrease of risk. The Working Paper No. 73 was particularly concerned with the issues of non-disclosure and breach of warranty which were regarded as the most controversial issues in insurance contracts. The Working Paper was of the view that the duty of disclosure of the insured should continue to exist and the insurer should remain entitled to avoid a contract of insurance on breach of this duty, objecting to the view of the abolition of this duty. It also turned down the proposal of the retention of the duty of disclosure subject to proportionate recovery based on the notional premium that would have been charged with full disclosure, which was, in fact, a proposal in the E.E.C. Directive in 1977.¹¹

⁹Ibid., at para. 12

¹⁰R. Hasson criticized that the Committee's analysis of the duty of disclosure was extremely superficial. See, (1969) 32 M.L.R. 615, at p. 633 ; Also see, R. Merkin, [1981] L.M.C.L.Q. 347

¹¹See, articles 3 and 4 of the proposed E.E.C. Directive in 1977.

Instead, the Working Paper said that the extent of the duty of disclosure should be reduced and limited. In other words, modification of the existing duty of disclosure was the main aim of the Working Paper. The Working Paper suggested that where an insurer asks detailed questions on a proposal and the insured completes it, the insurer may be deemed to have waived the disclosure of information which was not specifically requested by the insurer. Therefore, the insured's duty of disclosure could be discharged by correct answers to the questions in the proposal form put by the insurer.¹² The Working Paper tried to reduce the scope of ambiguous questions on a proposal form by introducing a fair and reasonable construction.¹³

However, in the Working Paper, there was no detailed discussion as to the issue of the effect of the breach of the duty of disclosure, which was also in urgent need of reform. In addition, the insurer's duty of disclosure was not considered. As far as the above proposals are concerned, they could be ineffective in cases where the insurers prefer oral answers to issuing a proposal form. It would appear that these proposals in the Working Paper were compromised proposals as a result of the tense conflicting views as to the duty of disclosure between the insurance industry who argue that the duty of disclosure is still very important in practice in assessing the premium and the representatives of consumer interests and academic lawyers who maintain that the duty of disclosure imposes too heavy burden on the proposers. Inevitably, the Working Paper did not go far enough to mitigate the defects and harshness of the existing state of law, and consequently the device for adequate and proper protection for the insured was not provided. Therefore, a more positive reform was strongly required.

¹²However, the insured's residual duty of disclosure could still exist where the insured regards any information in his possession which is not requested on the proposal form as something which would be material to the insurer.

¹³See, the Working Paper No. 73, at paras. 32, 33, 59-66 and 71-74. ; R. Merkin, "Reports of Committees - The Law Commission Working Paper No. 73", (1979) 42 M.L.R. 544, at pp. 545-549

9.4. THE FINAL REPORT OF THE LAW COMMISSION IN 1980¹⁴

9.4.1. INTRODUCTION

After consideration of the responses to the Working Paper No. 73 from the insurance industry, consumer protection groups and academic lawyers, the Law Commission immediately produced its Final Report and Draft Bill in 1980. The nature of this final report seems to be the fruits from the criticism by judges, consumer groups, academic writings and law reform agencies. Once again, the urgent need of reform in the duty of disclosure in insurance contracts was more clearly revealed to the public.

The Law Commission clearly refused to accept the proposed E.E.C. Directive in 1977, in particular Articles 3 to 6 of the proposed Directive which dealt with the issue of non-disclosure and would cause dramatic changes in insurance contract law in the U.K., if implemented. According to Articles 3 to 6 of it, unlike the English law, information unknown to the insured but of which he should be aware was excluded from the scope of the duty of disclosure. In addition, the actual insurer, not the prudent insurer, was chosen as a standard of the test of materiality. Furthermore, an applicant must disclose facts which *may* influence the insurer's assessment or acceptance of the risk, whereas in English law the applicant is only required to disclose facts which *would* influence the judgment of a prudent insurer.¹⁵ In addition, the consequences of a breach of the duty of disclosure would be different, depending on the insured's state of mind.¹⁶ Therefore, if the breach is made innocently and the insurer discovers it after the claim is made, the

¹⁴The Law Commission's Report No. 104 on Insurance Law, Non-Disclosure and Breach of Warranty, Cmnd. 8064 (1980). Marine, Aviation and Transport Insurance (MAT) were excluded from the scope of the Report on the ground that the MAT, in their view, is largely commercial insurance between the parties who are well aware of the practice of the duty of disclosure and there has been no urgent pressure for reform. However, see, clause 1(2) of the Draft Bill.

¹⁵Of course, the question of whether there is big difference between the word "may" and the word "would" under the current test of materiality in the English courts still remains. See, Chapter 5 of this thesis.

¹⁶*Ibid.*, at paras. 4.18-4.31

insurer must pay claim in full, whereas if the breach is made innocently and the insurer discovers it before the claim is made, the insurer is given the right to propose an amendment to the contract within two months. If the insured does not accept the amendment such as increase of premium or imposition of a warranty with 15 days, the insurer may terminate the policy. If the insured breached his duty with the intention of deceiving, the insurer will retain all premium paid, will not meet any claim and may avoid the policy. Lastly, if the insured breached his duty and may be considered to have acted improperly and the insurer discovers it after the claim is made, the insured's entitlement is to be reduced in accordance with the proportionality principle. In practice, this case would be the great majority of claims. If the insurer discovers it before the claim is made under the same circumstance, the insurer is given the right to terminate contract or to propose amendment of terms within two months.

The Law Commission clearly objected to the proportionality principle, a basic feature of the proposed Directive, which enables the insured who is in breach of his duty of disclosure nevertheless to recover all or part of his claim unless his conduct was such as to justify its total rejection.¹⁷ The purpose of this principle is to reduce the amount recoverable by the insured in certain cases of failure to comply with his duty of disclosure but without depriving him of the whole of his claim. In other words, according to this principle, the insurer shall pay the policyholder a proportion of the compensation which would have been payable, if the insured had not failed in his duty of disclosure, which is equal to the ratio between the actually agreed premium and the notional premium which a prudent insurer would have charged with full information.

The Law Commission was of the view that the creation of this complex machinery envisaged by the proposed Directive in the vast majority of claims must lead to much uncertainty in practice, and would freeze English law indefinitely in an unsatisfactory

¹⁷Ibid., at paras. 4.2-4.17

state. Both the Law Commission and the insurance industry firstly criticized that calculating the reasonable notional premium would be difficult in the general absence of uniform risk-assessment and premium-rating.¹⁸ Secondly, there is no way of ensuring that the insured's recoverable claim is arithmetically reduced in the proportion of the actual premium to the notional premium. Thirdly, it is not easy for the methods of arithmetical calculation to be harmonized with the courts' discretion.¹⁹

However, this principle was supported by a member of the Court of Appeal in *Pan Atlantic Insurance Co. Ltd v. Pine Top Insurance Co. Ltd.*²⁰ The Vice Chancellor, who was a member of the Court of Appeal in this case, expressed his uneasiness at the outcome which could be brought about by the current test of materiality, focusing on the inadvertent non-disclosure under English law in which the remedy is simply all-or-nothing. He said that ;

"Justice and fairness would suggest that when the inadvertent non-disclosure came to light what was required was an adjustment in the premium or, perhaps, in the amount of the cover. Those are not options available under English law. The remedy is all or nothing. The contract of insurance is avoided altogether, or it stands in its entirety. This is not the only field in which English law still seems to adopt an all-or-nothing approach, when what is needed is a more sophisticated remedy more appropriate, and in that sense more proportionate to the wrong suffered."²¹

Under the all-or-nothing approach of English law, the insurer may avoid all liability for his own bad bargain even though he would have simply increased premium had he been aware of the undisclosed facts. The Vice Chancellor recommended the introduction of a judicial discretion into this field, suggesting an adjustment in the premium or in the

¹⁸R. Merkin, [1981] L.M.C.L.Q. 347, at p. 350

¹⁹Also see, J. Birds, *Modern Insurance Law* (3rd ed., 1993), at p. 109. He criticizes the proportionality principle as overly mathematical and unworkable approach, although he goes on to say that it does not seem right in non-fraud cases that the insured should forfeit all rights.

²⁰[1993] 1 Lloyd's Rep. 496

²¹*Ibid.*, at p. 508

amount of the cover, because the current test of materiality along with the consequences of the breach of the duty has operated almost exclusively to the advantage of the insurer and cannot produce a satisfactory and fair result. According to this so-called proportionality principle, the insured who had not acted fraudulently should be allowed to recover a proportion of his loss based on the amount of premium actually paid, expressed as a proportion of the notional premium that would have been charged with full disclosure.

This principle was adopted in the Insurance Ombudsman Bureau 1989 and 1990 Reports. In the Reports, the Ombudsman said that if the insured's non-disclosure was inadvertent, he would require the insurer to adopt the proportionality principle on the condition that if the insurer had been aware of the non-disclosed fact, the insurer would not have declined the risk, but would have only increased the premium. Likewise, in relation to operation of this proportionality principle, the Ombudsman needs to require the insurer to prove, in order to avoid the application of this principle, that the insurer would have declined the risk if he had been told the non-disclosed fact.²² It would appear that this practice, i.e., requiring the proof of the insurer, can be reinforced by the recent decision by the House of Lords in *Pan Atlantic* case.²³

This principle, according to the Insurance Ombudsman Bureau, was regarded as fair and reasonable. However, this benefit is available to the insured only when his insurer is a member of the Insurance Ombudsman Bureau, and the introduction of this principle would require statutory change, which is unlikely to be made.

²²Also see, A. Forte, "The Revised Statements of Insurance Practice - Cosmetic Change or Major Surgery?" (1986) 49 M.L.R. 754, at p. 764

²³When the Vice Chancellor supported this principle in the Court of Appeal in the *Pan Atlantic* case, the requirement of inducement was not accepted and the anti-decisive influence test was the sole requirement in avoiding the contract for non-disclosure. Therefore, the insurer did not have to prove that he would have acted differently with full disclosure.

Apart from the above reasons, the Law Commission also pointed to some uncertainty as to the territorial scope of the proposed Directive.²⁴ According to the E.E.C. Directive, the risk should be situated within the E.E.C. Therefore, if the risk is outside, another rule should be applied, which may cause practical inconveniences and difficulties. In addition, the proposed E.E.C. Directive mainly deals with long term cover extending over several years. In England, with the exception of life insurance, most contracts of insurance are for a period of one year only. In other words, life insurance is the only long term insurance among the major type of insurance. However, the proposed E.E.C. Directive does not apply to life insurance. Based on this territorial problems, the Law Commission was of the view that it was undesirable and impracticable to apply the proposed E.E.C. Directive in this country.

9.4.2. SOME OF PROPOSALS AS TO THE DUTY OF DISCLOSURE BY THE LAW COMMISSION

In the final recommendation of the Law Commission, they expressed their own view that the current law as to the duty of disclosure was defective, therefore the current law was in need of urgent reform.²⁵ They admitted that this reform had been too long delayed, expressing the negative view as to the method of self-regulation made by the insurance industry as a way of reform. In other words, the Law Commission was of the view that the current interpretation of the duty of disclosure has been unduly tilted to the insurer in his favour. However, it objected to the abolition of the duty of disclosure. This was because, the Law Commission thought, insurers in certain types of commercial insurance still often rely on both the insured's duty of disclosure and the insurer's own inquiry, therefore the abolition of the duty to disclose would significantly undermine the insurer's position. From this conclusion, it would appear that the duty of disclosure in a case

²⁴The Law Commission's Report No. 104 on Insurance Law, Non-Disclosure and Breach of Warranty, Cmnd. 8064 (1980), at paras. 1.10-1.11 and 1.21 ; Also see, R. Merkin, [1981] L.M.C.L.Q. 347, at pp. 349-351 ; R. Hodgkin, Ibid., at pp. 284-285

²⁵Ibid., at paras. 1.21 and 10.5

where the insured is a consumer could be abolished because this kind of insurance relies largely on a proposal form, not oral answers, and the insurer's position can be secured by asking the relevant questions he wants to know on the proposal form. However, the Law Commission did not distinguish these differences between consumer insurance and commercial insurance, and eventually rejected the proposal for the abolition of the duty of disclosure.²⁶

Instead, the Law Commission recommended that the duty to disclose should be modified. According to the recommendations, the applicant should disclose only those material facts actually known to him or which could have been ascertained by reasonable inquiry, and which a reasonable man in the position of the proposer would disclose to the insurer, having regard to the nature and extent of the insurance cover which is sought.²⁷ Therefore, although the test of materiality in s. 18 of the M.I.A. 1906 still remains, the scope of the knowledge to be disclosed is restricted in terms of the restricted concept of deemed knowledge. Therefore, no duty of disclosure will be imposed on the applicant if a reasonable man applying for the insurance in question could not have ascertained a material fact. In fact, these recommendations are similar to the reasonable insured test.²⁸

Likewise, these proposals would reduce the scope of constructive knowledge of the applicant, and as long as the insured acts reasonably in the circumstance he could be protected by these proposals. In relation to deciding reasonableness of the insured's actions, the courts may differentiate the standard of reasonableness between the inexperienced ordinary applicant and the experienced applicant who is a professional

²⁶*Ibid.*, at paras. 4.32-4.42 ; R. Merkin, [1981] L.M.C.L.Q. 347, at p. 349 ; (1979) 42 M.L.R. 544, at p. 547-548

²⁷*Ibid.*, at paras. 4.47-4.53

²⁸As to the analysis of the prudent (reasonable) insured test, see, Chapter 5 of this thesis.

businessman.²⁹ This is the similar suggestion as recommended by the Law Reform Committee in 1957.³⁰

The recommendations also require the insurer to warn the insured of the existence of the residual duty of disclosure in the absence of a general question on the proposal forms. This is because the insured may be unaware that his duty to disclose material facts exists beyond answering specific questions on the form. The warning should also include the consequences of the insured's failure to fulfill his duty in relation to both the specific questions and a general question on the form. These warnings should be made in a clear, explicit and prominent way. In addition, the insurer must supply the proposer a copy of the completed proposal form and any other written information provided by the proposer when the contract is concluded. A breach of these requirements will deprive the insurer of his right to avoid the policy for non-disclosure of a material residual fact unless the court is satisfied that the insured has not been prejudiced by the failure of the insurer's duty to warn.³¹

The recommendation also requires that clear and explicit warning of the existence of the insured's duty to disclose any material change in circumstances and of the consequences of any breach of his duty when the insurer sends out a renewal notice. This is because most insurance policies in England, other than policies of life insurance, are renewable annually and renewal is regarded as creating a new contract, imposing the duty of disclosure on the insured. However, most insureds are unaware of the existence of any duty of disclosure on renewal. Therefore, these warnings on renewal are very important in terms of modification of the duty of disclosure. Furthermore, according to the

²⁹F. Achampong, (1987) 36 I.C.L.Q. 329, at p. 346 ; R. Merkin, [1981] L.M.C.L.Q. 347, at p. 351 ; R. Hodgkin, Ibid., at pp. 288-289

³⁰(Conditions and Exceptions in Insurance Policies), Cmnd. 62 (1957), at para. 14

³¹The Law Commission's Report No. 104 on Insurance Law, Non-Disclosure and Breach of Warranty, Cmnd. 8064 (1980), at paras. 4.64-4.68

recommendations, where the insurance policy was initiated by proposal form, on renewal the insurer should supply the insured with a copy of any documents supplied by the insured when the original proposal was made.³²

9.4.3. COMMENTS ON THE RECOMMENDATIONS

There is not doubt that the purpose of the recommendations were to mitigate the defects of the law in the duty of disclosure in insurance contracts. However, it would appear that the Law Commission also took into account the reactions or the opinions from the insurance industry. In other words, this final report repeated in many aspects the compromise put forward in the Working Paper in 1979. Therefore, they did not go far enough. There are some comments on the Law Commission's recommendations as to the issue of the duty of disclosure. Firstly, the extent of the duty might vary by introduction of the standard of the reasonable man in relation to the insured's duty of disclosure. It means that the extent of the duty will depend on interpretation as to 'reasonableness' by the courts.³³ Considering the past tendency of the courts which has been in favour of the insurer in interpretation of the duty of disclosure, there is no absolute guarantee of this proposal's success in practice. The majority of people without legal knowledge are likely to be unaware of the existence of the duty of disclosure, but it is possible that this duty may be imposed on these people in the name of 'reasonableness'. The uncertainty of this recommendation could be seen in particular in cases where no proposal form was used. Therefore, its success is questionable in practice.

Nevertheless, this reasonable man test seems to be easier for the courts to apply than the current prudent insurer test which requires the practice of expert evidence to decide the

³²Ibid., at paras. 4.69-4.84

³³J. Birds, [1982] J.B.L. 449, at p. 454

issue of materiality. This is because the new proposal is merely a test of 'reasonableness' of people, and judges seem to have been already familiar with this standard through practice without relying on extra evidence.³⁴ It would appear that this proposal is an improved and fairer attempt to protect the insured, although its success will largely depend on the courts.

Secondly, the Law Commission's recommendations did not distinguish the differences between the law applying to individual consumers and the law applying to business consumers. There is no doubt that while big business commercial consumers are able to protect themselves by various ways in insurance contracts, individual consumers are most likely to be prejudiced by the duty of disclosure which is strict in nature. The Law Commission's recommendations should have reflected this difference and the duty of disclosure in individual consumer cases should have been more modified by limiting the scope of material facts which should be disclosed to something which directly affects the risk in question.³⁵

Thirdly, as to the insured's residual duty of disclosure, this recommendation seems to be a retreat from their earlier view of the Working Paper No. 73 which said that the insured's duty should be discharged by truthful answers to questions on the form and that there should be no residual duty of disclosure. This retreat seems to be due to the successful lobbies from the insurance industry. This retreat is disappointing. It would appear that the better view is that, if a proposer of an insurance policy correctly answers to the detailed and lengthy questions on the form, his duty to disclose should be discharged and any residual duty in the absence of a general question on the proposal form should not be imposed on the insured.

³⁴Also see, R. Merkin, (1976) 39 M.L.R. 478, at p. 480

³⁵J. Birds, *Ibid.*, at p. 453 ; R. Merkin, [1981] L.M.C.L.Q. 347, at pp. 351-352 ; Also see, ss. 8 and 189 of the Consumer Credit Act 1974 and the Unfair Contract Terms Act 1977

Fourthly, there is no new proposal for the consequences of a non-disclosure. The proportionality principle was rejected and the all-or-nothing approach was still adopted. Therefore, in the case of an inadvertent non-disclosure, an adjustment in the premium or in the amount of the cover is not allowed. In addition, there was no discussion as to the requirement of a nexus between a loss and the non-disclosed fact. A nexus should be required to limit the scope of the duty of disclosure if a general duty of disclosure is retained. Finally, there was no detailed discussion as to the issue of the insurer's duty of disclosure which is naturally required by the principle of the reciprocity of the duty of disclosure.

Despite the above criticism, however, it cannot be ignored that the Law Commission's recommendations have strongly suggested the urgent need for reform in non-disclosure in insurance contracts and consequently the urgent need for reform in this area has been more clearly exposed to the public. In general, those recommendations should be by and large welcomed in terms of the protection of the insured and the government should reconsider legislative reform.

CH. 10 SELF-REGULATION IN INSURANCE LAW AND CONCLUSION

10.1. GENERAL CONSIDERATION

It remains the case that insurance in England has been the least regulated of contracts, although a lot of aspects of the law of insurance and related practices of insurers have been subjected to criticism.¹ In other words, the English insurance contracts have unusually survived major statutory control and reform, despite the fact that it has been recognized by the Law Commission, consumer organizations and academic lawyers that the English insurance law and practice contain a lot of potential unfair and harsh doctrines which have been interpreted both in theory and in practice against the insured. Even insurers themselves admit the potential harshness of the law. The insured's wide duty to disclose material facts is one of the noticeable example of the defects in the sense that it can be widely used for the technical defences by the insurers who wish to avoid their liability for non-disclosure. Of course, there have been some legislation such as Life Assurance Companies Act 1870, the Policyholder Protection Act 1975, the Insurance Brokers (Registration) Act 1977 and the Insurance Companies Act 1982. However, in England, the insurance contract itself which largely contains the defects in policy terms and conditions has still survived the major legislative controls, unlike a civil law system in which the statutory controls have been much more prevailing.

¹J. Birds, *Modern Insurance Law* (3rd ed., 1993), Sweet & Maxwell, at pp. 3-6, and 108-112 ; "Self-regulation and Insurance Contracts" in *New Foundations for Insurance Law* (1987), Stevens, at pp. 1-14 ; "Warranties and waiver of the duty of disclosure", [1984] J.B.L. 163 ; "Code of Practice - The Statement of Insurance Practice- A measure of regulation of the insurance contract-" [1977] 40 M.L.R. 677 ; J. Birds and C. Graham, "Complaints Mechanism in the Financial Services Industry", (1988) 7 Civil Justice Quarterly 313 ; R. Hodgkin, *Protection of the Insured*, (1989) Lloyd's of London Press Ltd ; I. Cadogan and R. Lewis, "Do Insurers Know Best? - An Empirical Examination Of The Extent That Insurers Comply With Their Statements Of Practice And Whether They Are A Satisfactory Substitute For Reform Of The Law", (1992) 21 Anglo-American Law Review 123 ; A. Forte, "The Revised Statements of Insurance Practice - Cosmetic change or major surgery?" [1986] 49 M.L.R. 754 ; R. Lewis, "Insurers' agreements not to enforce strict legal rights: Bargaining with government and in the shadow of the law", [1985] 49 M.L.R. 275 ; P. Morris, "The Insurance Ombudsman Bureau and Judicial Review", [1994] L.M.C.L.Q. 358

It would appear that one of the main reasons for the insurance law's special position in England is that the insurance industry has been successful over the years in persuading the government that the insurers' voluntary agreements not to enforce their strict legal rights are enough to control the policy terms and conditions and these voluntary agreements work very well in practice. In general, there are two types of agreements. The first one is made between the insurers themselves mainly for private commercial reasons instead of the threat of legislation by the government. The second one is the agreements with the government in order to avoid the official criticism of the practice in the insurance industry and in order to persuade the government not to forward legislative reform which might otherwise widely regulate the insurance industry.

In fact, apart from compulsory liability insurances, the government has shown little enthusiasm for legislative controls of the insurance contract itself. Instead, the government has made some agreements with the insurance industry, which regulate specific insurance practices on a non-legal basis. From the government's point of view, the agreements may have saved legislative time and provided a speedy and perhaps more flexible approach to the problem. The recent emphasis of the relationship of law and economics might facilitate this tendency, which does not require formal legislation.²

In 1980, the the Law Commission, which was asked by the government to investigate and report on the operation of the principle of the duty of disclosure, produced a final report which suggested considerable reforms and made a draft bill implementing these proposals. At one time, the government had intended to implement this bill with minor amendments. However, the government was persuaded again by the insurance industry

²Generally see, R. Lewis, *Ibid.*, at pp. 275-276 and 289-292 ; As to the reasons for preference of self-regulation in England, see, R. Hasson, "The special nature of the insurance contract : A comparison of the American and English law of insurance", (1984) 47 M.L.R. 505 ; Also see, C. Schmitthoff, "The concept of economic law in England", [1966] J.B.L. 309 ; T. Daintith, "Public law and economic policy", [1974] J.B.L. 9

not to establish any legislative reform. Instead, the insurance industry provided several forms of so-called self-regulation. One example can be easily found in the Motor Insurers' Bureau Agreements. Under the threat of state control by legislation or nationalization, the motor insurance companies agreed with the government in 1946 to set up a central fund and the Motor Insurers' Bureau in order to help the victims of the drivers who are uninsured in relation to the operation of liability insurance for road accidents.³

This final chapter of this thesis will analyze some best known forms of self-regulation such as the Statements of Practice which mainly deal with some contractual doctrines, two complaints mechanisms for the insureds outside the courts - the Insurance Ombudsman Bureau (I.O.B.) and Personal Insurance Arbitration Service (P.I.A.S.) and the Codes of Practice which regulate the aspects of insurance intermediaries. These analyses will show whether or not self-regulation provides adequate protection for the insured and whether or not legislative reforms and controls are ultimately required. Finally, summary of the suggestions for reform as regarding the principle of the duty of disclosure in insurance contract law will be provided as a conclusion of this thesis.

10.2. STATEMENTS OF INSURANCE PRACTICE⁴

10.2.1. INTRODUCTION

In 1977, the Association of British Insurers, Lloyd's and life assurance organizations adopted two Statements of Insurance Practice, one for general insurance and the other for life and long-term policies, in response to the exclusion of contracts of insurance from the wide scope of the Unfair Contract Terms Act 1977, which was based on the

³For the detailed discussion as to the agreements including the Motor Insurers' Bureau Agreements, see, R. Lewis, *Ibid.*, at pp. 277-289

⁴See, Appendices 1 and 2

Law Commission's Second Report on Exemption Clauses (no. 69).⁵ These two Statements became the most marked examples of self-regulation provided by the insurance industry at the expense of legislative control. The main purpose of this measure was to mitigate the strict legal right of insurer to avoid a policy for the insured's non-disclosure of a material fact. The insurance industry maintained that they would only exercise their right to repudiate liability or to reject a claim under the policy for non-disclosure when it was reasonable for them to do so. In addition, the insurance industry also insisted that the Statements had worked very well in practice, therefore any statutory reform of the law as to the duty of disclosure was unnecessary.

However, this self-regulation was not satisfactory from the Law Commission's point of view in 1980.⁶ In fact, the statements were not always complied with in practice. The government seriously considered the possibility of statutory reform based on the Law Commission's final report and a draft bill, which regarded the Statements in 1977 as unsatisfactory, and eventually significantly modified the duty of disclosure. In order to persuade the government not to implement the recommendations made by the Law Commission, the insurance industry had to accept some of the Law Commission's recommendations and had to reissue the Statements in an updated form in 1986 after another successful lobby against the legislative reform.⁷ The Statement of General Insurance Practice presupposes that the contract has been initiated by a proposal form. However, in 1993, an addition was made again to the existing Statement of General

⁵There is a view that it is a desirable omission that contracts of insurance were excluded from this Act, because the meaning of a fair and reasonable test in the recommendation and in the Act is uncertain in the insurance field. See, J. Birds, "Code of Practice - The Statement of Insurance Practice- A measure of regulation of the insurance contract-" [1977] 40 M.L.R. 677, at pp. 677-678

⁶Law Com. No. 104, *Insurance Law: Non-disclosure and Breach of warranty*, Cmnd. 8064 (1980), at para. 3.28 (hereafter Cmnd. 8064 (1980)) ; As to the criticism of the Statements in 1977, see, J. Birds, *Ibid.* at pp. 679-684. He described it as a mere "token gesture to consumerism" effecting little change in practice. ; Also see, MacGillivray and Parkington, (7th ed., 1981), at para. 705

⁷Cmnd. 8064 (1980), at paras. 1.6 and 3.23-3.30 ; Also see, P. North, "Law reform: Process and Problems", (1985) 101 L.Q.R. 338, at pp. 349-350

Insurance Practice, dealing with the case in which the policy is not initiated by a proposal form or in which a shortened version only has been used. In these situations, the guidelines issued by the A.B.I. in 1993 require the insurers to apply the spirit of the Statement.⁸

10.2.2. ANALYSES ON REVISED STATEMENTS IN 1986⁹

10.2.2.1. SCOPE OF APPLICATION

In general, the revised Statements issued in 1986 were based on the recommendations of the Law Commission in 1980. Therefore, it might be said that these Statements now become a non-legislative enactment of recommendations of the Law Commission.¹⁰ The Statements only apply to private or consumer contracts of insurance.¹¹ Therefore, even the small businessman who is unaware of the existence of the duty of disclosure cannot be protected by these Statements.¹²

It fails to distinguish difference in terms of knowledge, experiences and business size between a small businessman such as the one-man business and a multinational company who can be easily advised by the professional lawyers. Considering the fact that the defects of the current law as to the duty of disclosure are found in both the individual insured case and the commercial policyholder case, the limitation of this Statement to

⁸As to the text of the guidelines, see, R. Merkin, *Tolley's Insurance Handbook*, (1st ed., 1994), Tolley Publishing Co. Ltd., at pp. 232 and 235

⁹Unless otherwise stated, all paragraphs cited here are from the Statement of General Insurance Practice.

¹⁰J. Birds, "Self-regulation and Insurance Contracts" in *New Foundations for Insurance Law* (1987), Stevens, at p. 2

¹¹As to the definition of "consumer", see, Unfair Contract Terms Act 1977, ss. 12 and 25(1)

¹²This may not be harsh on large commercial organizations.

the individual insured seems unreasonable and unduly harsh on the small business insured.¹³

10.2.2.2. NON-DISCLOSURE AND MISREPRESENTATION

Paragraph 2(b)(i) seems to modify, to an extent, the current prudent insurer test in determining materiality by superimposing the standard of reasonableness of a prudent insured by which a non-disclosure or misrepresentation is to be decided. In other words, it would appear that this paragraph will reduce, to an extent, the overall effect of the traditional definition of a material fact in s. 18 of the M.I.A. 1906 by providing that an insurer will not repudiate liability to indemnify a policyholder on the ground of non-disclosure of a material fact which a policyholder could not reasonably be expected to have disclosed. In relation to the interpretation of this paragraph, it would appear that reasonableness of a man in the position of the proposer is different from that of a reasonable insurer. Based on this, the insured does not have to disclose all the facts which the insurer might want to know, but only as much as a reasonable man in his position could be expected to disclose.

However, it would appear that this modification might be weakened by the fact that the insurer becomes the initial judge of whether or not the insured has acted reasonably, in other words, whether or not a reasonable man in his position should have disclosed the fact in question. Therefore, in practice, the effect of this paragraph eventually will depend on whether or not the insurer has reasonably acted in deciding whether the fact in question should have been disclosed. In addition, the fact that the paragraphs which deal with the modified duty of disclosure are separately situated under different headings, one (1(c)) for proposal form, the other (2(b)) for claims, possibly makes it less effective to achieve the original purpose of modification of the duty of disclosure, which

¹³Compare, ss. 8 and 189 of Consumer Credit Act 1974 and ss. 3 and 17 of Unfair Contract Terms Act 1977 in which the equal treatment of consumers and small businessmen is found. ; Also see, A. Forte, *Ibid.*, at p. 756

gives the insured the idea of what kind of information he is really expected to disclose to the insurer.¹⁴

According to paragraph 2(b)(ii), the common law right to avoid the contract for innocent non-disclosure and misrepresentation is now removed. This is undoubtedly welcomed. However, criticism for this paragraph is that it may be harsh to repudiate liability for a negligent misrepresentation, which is the equal effect with that of the deceitful misrepresentation. This criticism may be supported by the fact that in some cases the distinction between innocent and negligent misrepresentation is not always clear, because the misrepresenter does not realize he is doing wrong.¹⁵ The issue of the proportionality principle which was rejected by the Law Commission in 1980 can be considered in relation to this criticism.¹⁶

It would appear that the Long-Term Statement as regarding non-disclosure and misrepresentation in paragraph 3(a) is stipulated by clumsy and ambiguous wording. First of all, the expression "unreasonably" in the first sentence is unnecessary. It might lead to an undesirable result, because, as a result of this expression, it is possible for the insurer to refuse a claim, although there is no fraud or negligence, by arguing that it was reasonable to do so. This expression, which existed in the Statements in 1977, is removed in the General Statement.¹⁷

Secondly, a reference to reckless or negligent non-disclosure or misrepresentation in parenthesis in this paragraph seems to be inconsistent with sub-paragraph (iii) in some sense. According to sub-paragraph (iii), the effect of negligent non-disclosure or

¹⁴A. Forte, *Ibid.*, at pp. 764-766

¹⁵R. Hodgkin, *Ibid.*, at p. 116

¹⁶See, Chapter 9 of this thesis.

¹⁷Paragraph 2(b) of General Statement.

misrepresentation *will* entitle an insurer to reject a claim, whereas the effect of negligent non-disclosure or misrepresentation in the parenthesis *may* constitute grounds for rejection of a claim. This potential difference in terms of effect might cause confusion and ambiguity in practice.

10.2.2.3. WARNINGS AND STATEMENTS

The requirements that the proposers must be warned of the need for disclosure on proposal forms of both Statements and on renewal notices in the case of general insurance¹⁸ must be considered together in relation to the interpretation of para. 2(b) of General Statement and para. 3(a) of Long-Term Statement. These requirements seem to reflect the existing negative view as to the principle of the insured's duty of disclosure based on the fact that most of ordinary people do not know of its existence. These requirements might imply that retention of the duty of disclosure, at least in individual insurances, can be justified only when the proposers are aware of its existence.¹⁹ Paragraph 1 (c) (ii) implies the existence of the residual duty of disclosure, because it shows indirectly that truthful answers to questions made by the insurers on proposal form may not necessarily discharge the insured's duty of disclosure.

As regarding the statement of warning that if the proposer is in any doubt about facts considered material he should disclose them, it should be "prominently" displayed on the proposal forms of both Statements, if it is not included in the declaration at the foot of the proposal form.²⁰ The requirement of "prominent" should be performed by the insurer in a way which would clearly show the real meaning to the individual consumer.

¹⁸Paras. 1(c) and 3 of General Statement. Also see, para. 1(a) of Long-Term Statement.

¹⁹J. Birds, "Self-regulation and Insurance Contracts" in *New Foundations for Insurance Law* (1987) 1, at p. 6

²⁰Therefore, if it is included in the declaration, it is not required to be prominent. See, Para. 1(c) and para. 1(a) of the General Statement and Long-Term Statement respectively.

However, in the case of warnings on renewal notices, warnings need not be prominent.²¹ It would appear that it unreasonable to have omitted the expression "prominent" on renewal notice, considering the fact that most of ordinary people probably do not recognize the existence or importance of the duty of disclosure at the time of renewal, because, unlike a proposal form, no questions are expressly asked to the insured on renewal. General insurance policies are periodic and each renewal creates a new contract with the new duty of disclosure. This paragraph enjoins the insurer to warn the insured of this duty of disclosure on renewal. To achieve the purpose of the warning on renewal notice, the insurer should make it clear by well-defined and prominent warning that what the renewer is required to do on renewal.

Paragraph 1(d) has raised some important points. First of all, the obligation on the insurer to ask questions about facts which have been generally found to be material may make it rather more difficult than is the case under the strict law for the insurer to prove the materiality of a question not asked.²² Secondly, it clearly stipulates that the questions should be clear in order to avoid vaguely worded questions which might lead to the insured's materially inaccurate answers. Thirdly, this paragraph leaves a room for the debate of the insured's possible residual duty of disclosure. This issue, the residual duty of disclosure, is closely related to the requirement of warning in paragraph 1(c). As regarding the relationship between paragraph 1(c) and paragraph 1(d), in a non-disclosure case where a warning of the need for the duty of disclosure was included on the proposal form, a judge regarded the warning as a waiver of the insured's duty of disclosure of material facts outside the express questions asked on the form.²³ Woolf J. in this case said ;

²¹Para. 3 of General Statement.

²²R. Merkin, *Tolley's Insurance Handbook*, at p. 233

²³*Hair v. Prudential Assurance Co. Ltd* [1983] 2 Lloyd's Rep. 667. This case is a good example to show the relationship between the insured's duty of disclosure and the contents of a proposal form such as warnings and asking clear questions as to the facts which have been generally found to be material by the insurer.

"I am bound to say that, if it was intended that an assured should answer matters even though he is not being questioned about them, I would expect a different form of statement from the one to which I have just made reference. I would have expected something to be said which clearly indicated to a proposer that, although they had not been asked any specific question about the matter, if there was something which was relevant to the risk which they knew of, but which was not covered by the questions, they should still deal with it, and leave a space for them to do so."²⁴

It would appear that his interpretation suggests that there is no residual duty of disclosure on a proposer outside the specific questions made by the insurer (waiver of the duty of disclosure), unless the insurer's warning in a proposal form clearly indicates this point. In relation to this interpretation, the judge seemed to be based on the view that the questions asked in a proposal form by the insurer may limit the scope of the insured's duty of disclosure. In addition, it would appear that he was also influenced by the following test: "would a reasonable man reading a proposal form be justified in thinking that the insurer had restricted his right to receive all material information and consented to the omission of the particular information in issue?"²⁵

It might be criticized that Woolf J. interpreted the doctrine of waiver in a very generous way, compared with the previous interpretations of the doctrine of waiver. In particular, this criticism might be understandable considering the facts of this case. In general, however, Woolf J.'s interpretation should not be castigated. If the insurer develops clearer and more explicit proposal form, which is required in paragraph 5, and if he complies fully with paragraph 1(d), it is questionable why there still remains any need to retain the insured's residual duty of disclosure.²⁶ It would appear that this interpretation is supported by the additional requirement of the standard of a reasonable insured both in the Statements and in the Law Commission's recommendations, because a reasonable man would not normally think that he had to do more than provide the material facts

²⁴*Ibid*, at p. 673

²⁵*MacGillivray and Parkington*, (7th ed., 1981), at paras. 626-627

²⁶Also see, A. Forte, *Ibid.*, at pp. 762-763

expressly asked by the insurer in the proposal form.²⁷ The Law Commission agreed with the retention of the insured's residual duty to disclose material facts outside the questions in a proposal form only where there are clear and explicit warnings to the insured of the existence of the insured's residual duty to disclose material facts, apart from answering the questions.²⁸

A number of the lay public cannot be expected to have the same understanding of what is 'material' as a proposer for commercial insurance. A warning couched in the legal language of a statute conveys little to the average proposer. The underwriter should decide what information he really needs to assess the risk and what he can do without. He can then ask for specific relevant information he really needs in his business in the proposal form. An ordinary member of the public should not be expected to interpret the raw material of a statutory definition without specific guidance in the form of questions or, at the very least, declarations.²⁹

Undoubtedly, the requirements of warnings of the need for disclosure and of asking those matters which insurers have found generally to be material would give the proposers an opportunity to apprehend the existence of the duty of disclosure. The insurer should comply with these requirements in an open manner with clearer and more explicit words by plain English, giving the full explanation as to the scope of the duty and avoiding asking obscure questions which would require expert knowledge beyond that which the proposer could reasonably be expected to possess.³⁰

²⁷J. Birds, [1984] J.B.L. 163, at pp. 165-166 ; cf. R. Hasson, *Ibid.*, at p. 509

²⁸Cmnd. 8064 (1980), at paras. 10.13-10.14

²⁹Merkin & McGee, A.5.8-03

³⁰Paragraph 1(e). However, the phrase "so far as is practicable" may limit its effect. See, R. Hodgkin, *"Protection of the insured"*, (1989) Lloyd's of London Press Ltd., at p. 113

An obligation is imposed on the insurers to keep proposal forms accessible to the policyholders in paragraph 1(h). This obligation seems to be related to paragraph 3, because, if the insured has not retained a record of all information supplied to the insurer, or if a copy of proposal form is not available to the insured, it will be difficult for him to advise changes affecting the policy which have occurred since the policy inception, as he might have a very poor memory as to the subjects regarded by the insurer as material and as to the facts which he already supplied to the insurer. Law Commission proposed that the insured should be supplied *on each renewal* with a copy of information he has previously sent,³¹ but the Statements did not adopt this recommendation.

10.2.2.4. CONCLUSION

The Statements as a self-regulation by the insurance industry cannot be a sufficient solution to the defects of the law in non-disclosure in insurance contracts, although it is true that the Statements have produced some modification in the wording used in the proposal forms and policies providing a measure of protection for the individual insured. The Statements, which were based on the Law Commission's recommendations, do not deal with the problems which the Law Commission ignored. In general, as a result of the insurers' agreements with the government, the insurers may have managed to retain their considerable discretion in operating their business by escaping from public control such as legislation. In addition, it is possible to say that, as a result of the insurer's agreements with the government, the creation of rights on which the public can directly rely and by which the public can be more protected may be prevented by these agreements.³² The insurance industry strongly maintain, as a reason for objection to the statutory reform, that they always apply the law fairly and use a technical defence like non-disclosure only

³¹Cmnd. 8064 (1980), at paras. 4.77-4.80

³²R. Lewis, *Ibid.*, at pp. 289-292

when they suspect fraud. However, it is highly questionable that the insurers should be permitted effectively to remain judges in their own cause.³³

One of the weak points of the Statements is the fact that they are not legally binding on the insurance companies. Although it is a condition of membership of the Association of British Insurers (A.B.I.) and Lloyd's of London that they comply with the Statements, the sanction for non-compliance with the Statements is nominal and ineffective, the manner in which the Statements are implemented varies company by company and no organization for monitoring compliance exists. The Statements do not apply to the insurers who are not memberships of the A.B.I. or of Lloyd's, although they are expected to comply. They do not apply to business consumers of insurance, even though the size of their business is very small and consequently the same amount of protection is needed as individual consumers. In other words, its weakness comes from the nature of self-regulation itself and a lack of legal force. The Statements should be a supplement to the legislative reform, instead of a substitution for it. The Law Commission's Report in 1980 showed the negative view as to the method of self-regulation as a way of reform in the issue of non-disclosure in insurance contracts. In conclusion, the Statements differ in many aspects from the possible legislative reform which was proposed by the Law Commission in 1980 and consequently less protection is given to the insured.³⁴

10.3. ACTIVITIES OF CONCILIATION AND ARBITRATION SERVICES

10.3.1. INSURANCE OMBUDSMAN BUREAU³⁵

10.3.1.1. INTRODUCTION

³³J. Birds, *Modern Insurance Law*, at p. 109

³⁴I. Cadogan and R. Lewis, *Ibid.*, at p. 137

³⁵Generally see, J. Birds and C. Graham, "Complaints Mechanism in the Financial Services Industry", (1988) 7 Civil Justice Quarterly 313

The Insurance Ombudsman Bureau (hereafter I.O.B.) was established in 1981 by three leading insurance companies probably as a response to enormous concern among the consumer representatives that the consumers of insurance were quite badly treated in insurance contract law. The main purpose of the I.O.B. is to receive complaints, disputes and claims from policyholders who entered into contracts with member companies and to deal with these matters in a way that they are settled or withdrawn between policyholders and the member companies.

The I.O.B. has been proved that it is a genuinely independent and impartial conciliator and arbitrator. In addition, the idea of providing a free complaints body for the policyholder has been welcomed. It has been said that the I.O.B. has offered the most appropriate service to both parties to the dispute. With the above reasons, the I.O.B. has been so successful and now most of the insurers dealing with private policyholders belong to this organization. The success of the I.O.B. has influenced other area such as banking services, building societies and unit trusts where Ombudsmen have been appointed to deal with complaints.³⁶

10.3.1.2. TERMS OF REFERENCE, JURISDICTION AND RESOLVING DISPUTES³⁷

The I.O.B. is controlled by a Board consisting of representatives of the member insurers and an independent Council, the majority of whose members are individuals representing the consumers and public interests. This Council has the power to appoint and oversee the Ombudsman. The running costs of the I.O.B. are paid for by charges to the member companies and the service is free to complainants. The I.O.B. publishes Annual Reports which provide the real insight into the operation of this organization, containing good

³⁶J. Birds, "Self-regulation and Insurance Contracts" in *New Foundations for Insurance Law* (1987) 1, at pp. 11-12 ; R. Hodgkin, *Ibid.*, at pp. 124-125 ; Also see, the Financial Services Act 1986

³⁷Generally see, J. Birds, *Ibid.*, at pp. 12-13 ; R. Hodgkin, *Ibid.*, at pp. 126-129 ; R. Merkin, *Ibid.*, at pp. 128-130

advice and suggestions to the insurers and policyholders. In the Annual Reports, the Ombudsman may highlight defects of insurance contract law in the hope that the members may change their practices in the future and even legislation may be established to correct them.

As regarding the jurisdiction, another self-regulatory organization, the Personal Investment Authority (hereafter P.I.A.) established under the Financial Services Act 1986 has recently created its own Ombudsman scheme and has mandatory jurisdiction in respect of policies issued by member companies which have an investment or savings element, which the I.O.B. used to have jurisdiction. Consequently, the I.O.B. now has the jurisdiction in respect of other personal insurance policies.³⁸

The Ombudsman plays the impartial part of counsellor, conciliator, arbitrator or adjudicator to facilitate the settlement or withdrawal of the complaints, disputes or claims referred to him by making an award or by other means. In exercising his functions, the Ombudsman shall have regard to the terms of the contract and act in conformity with any applicable rule of law, relevant judicial authority, general principles of good insurance, his terms of reference, the Statements of Insurance Practice and the Codes of Practice issued by the A.B.I.

The Ombudsman has the power to request any relevant information in relation to complaints from the member companies and also has the power to receive oral submissions as well as written submissions in resolving disputes. The Ombudsman is not required to stick to the general law, although he must take the law into account. In addition, he is not bound by his or his predecessor's own previous decisions, although, in

³⁸p. Morris, "The Insurance Ombudsman Bureau and Judicial Review", [1994] L.M.C.L.Q. 358, at p. 362

practice, he refers to them.³⁹ Of course, he relies on expert advice as well as on case-law where necessary.

However, the Ombudsman's discretion under the terms of reference has been regarded as most important one in resolving disputes. This discretion makes it possible that he relies on good insurance practice rather than the strict law. The example can be easily seen in respect of the questions of non-disclosure.⁴⁰ As a result of the amended terms of reference, the Ombudsman's decision is now required to be "fair and reasonable in all the circumstances". There is a six-month time limit within which the Ombudsman may receive a reference, running from the date of the member company's final decision. There are also restrictions on who can bring a reference to the Ombudsman.

Before the Ombudsman hears complaints, all internal appeals procedure within the member company in question, up to the chief executive level, must be exhausted first and the result has to be proved to be unacceptable to the complainant. In addition, he must be satisfied that there are no outstanding parallel legal and arbitration proceedings. If these conditions are fulfilled, the Ombudsman has jurisdiction to make a binding award against the insurer of up to £100,000.⁴¹ The member companies must follow his decision, but the consumer can reject it and proceed to exercise his legal rights in the court to seek a greater sum. If the above limits are exceeded, his decision becomes a recommendation which does not then bind the member companies, but the member company might consider it as a basis of a possible equitable solution. According to the recent case, decisions of the self-regulatory Ombudsman are not subject to judicial review, because the I.O.B. is not a public body. Rose L.J. in *R. v. Insurance*

³⁹The Annual Report for 1985, at p. 3

⁴⁰Paragraph 6 of the General Statement and paragraph 4 of the Long-Term Statement.

⁴¹£10,000 per annum in the case of health insurance.

Ombudsman Bureau, ex p. Aegon Life⁴² said that the I.O.B.'s decisions are of an arbitral nature in private law and those decisions are not supported by any public law sanction. In the light of all these factors, the I.O.B. is not a body susceptible to judicial review.⁴³

In practice, it is rare that the Ombudsman actually exercise his power to make an award. Instead, most of complaints are disposed of by way of conciliation. Giving informal advice such as the issue of 'letters of advice' to inquirers is one of his important functions. Likewise, his decisions are often accepted in an informal way, and it seems to be related with the fact that the Ombudsman regards himself as a conciliator as much as an arbitrator. Unlike the first Ombudsman, the current Ombudsman, who emphasizes the importance of informality and speed in decision-making, broadly interprets the Ombudsman's terms of reference which requires him to make decisions in accordance with good insurance practice as well as the law. This tendency seems to be supported by the amended terms of reference which requires him to make a decision which is fair and reasonable in all the circumstances.

Based on this, the current Ombudsman has shown some departure from the traditional interpretations of the law or the Statements of Insurance Practice. In 1989 Annual Report, the application of the principle of proportionality whereby an insured who has negligently broken his duty of disclosure will be allowed to recover a proportionate part of the loss, although it was rejected by the Law Commission, is a good example. In 1990 Annual Report, the Ombudsman was more radical, stating that in some cases he would allow the insurers to avoid, wholly or partially, a claim, but disallow them to avoid the policy at all. In relation to this, he relied on s. 2(2) of the Misrepresentation Act 1967 in

⁴²[1994] The Times, 7 January

⁴³As to the detailed analysis of this decision, see, P. Morris, *Ibid.*, at pp. 360-362

which awarding damages in the case of a negligent misrepresentation is available instead of rescission of the contract.⁴⁴

Under the requirement that the Ombudsman's decision should be fair and reasonable in all the circumstances, the Ombudsman imposes on the proposer an obligation to read and check the accuracy of a proposal form before signing in the case where the proposal form was completed by an intermediary. If the proposer breaches this duty, the Ombudsman will not ask the insurer to meet a claim unless there is evidence of the intermediary's mistake.⁴⁵ It would appear that this point is the Ombudsman's most frequently repeated piece of advice to the policyholders and it is the most common causes for the repudiation of claims other than the defence that the loss was not actually covered by the policy.⁴⁶

10.3.1.3. MISCELLANIES

While the operation of the Statements of Insurance Practice is monitored, even though it is ineffective, by the A.B.I., the practical enforcement of the Statements of Insurance Practice is in the hands of the I.O.B. There is no doubt that the current practices of the Insurance Ombudsman Bureau have a considerable effect on the law of non-disclosure in insurance contract law in particular in the case of private consumer insureds. However, reform of insurance contract law is still strongly required. Membership of the I.O.B. is not obligatory, in other words, it is optional. Therefore, some insurers, for one reason or another, may decide not to join this organization. It would appear that it prevents this organization from becoming a more effective complaints resolution body for the

⁴⁴In addition, the Ombudsman has struck down unduly onerous terms in insurance contracts which have not been brought to the insured's attention prior to the making of the contract. Also see, J. Birds, *Modern Insurance Law*, at pp. 5 and 112

⁴⁵Merkin & McGee, A.5.8-03-04

⁴⁶The Annual Report for 1985, at p 6 ; J. Birds, "Self-regulation and Insurance Contracts" in *New Foundations for Insurance Law* (1987) 1, at p. 13, footnotes 48 and 60

policyholder. It might also hamper the establishment of a currently acknowledged growing body of "consumer insurance law". Therefore, it is highly recommended that membership of this Bureau should be a prerequisite to authorization to conduct personal insurance business. It is also recommended that the Bureau should do their best for a wider circulation of the Annual Reports which contain important information for both the insurance industry and the private consumer insured.

10.3.2. PERSONAL INSURANCE ARBITRATION SERVICE

When the I.O.B. was established in 1981, it was not welcomed by the whole insurance industry. Some insurers, who was concerned about the practice of the I.O.B. that the insured is not bound by the Ombudsman's decisions and is free to exercise his legal rights in the courts if dissatisfied, and who consequently feared that the I.O.B. would become a consumer champion, although these fears proved groundless shortly after, set up a rival organization, Personal Insurance Arbitration Services (hereafter the P.I.A.S.). Likewise, the P.I.A.S. scheme was initially established for those insurance companies who did not join the I.O.B., although some companies now have joined both schemes. It is an arbitration service in the sense that the decision of the arbitrator is binding on both parties. This arbitration service is organized by the Chartered Institute of Arbitrators.

Like the I.O.B., the member companies' internal complaints procedure must be exhausted by the insured first, the procedure is free to the insured, the service is restricted to the private policyholders and the Statements of Insurance Practice are binding on the arbitrator. The arbitrator has an implied obligation to apply more favorable interpretation to the claimant between the general law and the Statements.

However, under the P.I.A.S. scheme, unlike the I.O.B., the decision of the arbitrator, i.e., the arbitration award, is binding on both parties. In addition, only a very small number of insurers issuing policies to the private policyholders use this service. Also, as

a result of the characteristic of arbitration, no report on its work is published because the deliberations and awards are confidential. Therefore, little is known about the P.I.A.S. scheme. There is no formal organization like the I.O.B. The P.I.A.S has shown less informal way in resolving disputes than the I.O.B., and the arbitrator under the P.I.A.S. seems to have less discretion in performing his function than the Ombudsman in the I.O.B. Under this situation, it would be less attractive to the policyholder, compared with the I.O.B. The future of the P.I.A.S. seems to be uncertain. In particular, the life insurance companies, which offer investment insurance policies, are likely to depart from the P.I.A.S. as a result of the establishment of the Personal Investment Authority which has recently created its own Ombudsman scheme under the Financial Service Act 1986.⁴⁷

10.4. CODES OF PRACTICE FOR INTERMEDIARIES⁴⁸

10.4.1. INTRODUCTION

There is no doubt that the existence of impartial, independent and competent intermediaries in insurance contracts is important, considering the fact that an intermediary is mostly involved in the procedure leading to the completion of the contract. There have been a lot of cases which clearly show conflicts between the intermediary's duty to obtain the best deal for his client and his own interests in obtaining the best deal for himself.⁴⁹ In 1970, the Consumer Council pointed out the necessity for the regulation of insurance intermediaries in order to satisfy the crucial requirement of

⁴⁷J. Birds, *Modern Insurance Law* (3rd ed., 1993), at pp. 4-5 ; "Self-regulation and Insurance Contracts" in *New Foundations for Insurance Law* (1987) 1, at pp. 12 and 14 ; R. Hodgkin, *Ibid.*, at pp. 139-140

⁴⁸Generally see, J. Birds, "Self-regulation and Insurance Contracts" in *New Foundations for Insurance Law* (1987) 1, at pp. 8-11 ; R. Hodgkin, *Insurance Intermediaries: Law and Regulation*, (1992) Lloyd's of London Press Ltd ; "Protection of the insured", (1989) Lloyd's of London Press Ltd., at pp. 89-95 ; D. Morgan, "Insurance Intermediaries - Recent and projected developments - Insurance Brokers (Registration) Act 1977", [1978] L.M.C.L.Q. 39

⁴⁹J. Birds, *Modern Insurance Law* (3rd ed., 1993), at pp. 178-179

competence and independence of insurance intermediaries. Although there had been some statutory devices, the scope of them seem to be very limited.⁵⁰ It would appear that the Insurance Brokers (Registration) Act 1977 has become a full-scale legislative intervention in this area with some amendments by s. 138 of the Financial Services Act 1986.

As far as independent intermediaries who are not registered under the Insurance Brokers (Registration) Act 1977 are concerned, in 1981 the Association of British Insurers issued some codes of conduct for general insurance, life insurance and industrial insurance, which have been regarded as a model of self-regulation. Among them, for one reason or another, only the first one, "General Insurance Business Code of Practice for All Intermediaries (Including Employees of Insurance Companies) Other Than Registered Insurance Brokers" is mainly applied at present.⁵¹ This Code was revised by the A.B.I. in 1989 to reflect the possible changes caused by the conduct of business rules under the auspices of the Financial Services Act 1986.

10.4.2. ANALYSIS OF CODE OF PRACTICE⁵²

The Code is concerned with general insurance business. The Code, based on the general principle that an intermediary should conduct business with utmost good faith, applies to both the independent intermediaries who are not registered under the Insurance Brokers (Registration) Act 1977 and those who are tied to one or more insurance companies (up to six companies) as an employee or an agent. The Code is divided into two parts. The first one is concerned when an intermediary is acting other than a mere "introducer", i.e.,

⁵⁰Regulations 67-69 of the Insurance Companies Regulations 1981 (S.I. 1981 No. 1654) ; Setion 74 of the Insurance Companies Act 1982

⁵¹The Life Assurance selling-Code of Practice has been largely superseded by conduct of business rules under the Financial Services Act 1986, whereas the Statement of Long-Term Insurance Practice in 1986 contains the contents of the code for industrial insurance.

⁵²See, Appendix 3

selling and servicing of general insurance policies, whereas the second part is concerned with an intermediary who is acting as a "introducer".

As regarding calling on the customer, unsolicited or unarranged call is possible if it is at an hour likely to be suitable to the customer, although he is advised to make prior appointment. It seems vague. No suggestions are made as to the hours between which such calls could be made. Many intermediaries are part-timer and what might seem to be appropriate to them may not commend themselves to the customer.⁵³

The Code requires the intermediary to declare, at the beginning of negotiations with the customer, his exact status as to whether he acts independently or whether his action is related to a company. The intermediary should also declare who has a responsibility for his action. To do so, a certificate which shows the intermediary's status and the name(s) of the company or companies for whom he acts can be used. By this requirement, the consumer will know with whom he is dealing and whose responsibility it is if things go wrong.

In relation to the intermediary's status which should be agreed by companies for whom he acts, the A.B.I. have made the standard criteria for the appointment of non-broker intermediaries, which is required to be adopted by its member companies. This criteria include detailed information of his business, professions, occupations, education level, standard of professional training, knowledge or experience to sell and service insurance policies, criminal records and the existence of professional indemnity insurance in the case of non-broker independent intermediary. In addition, if necessary, reference may be made to his bankers, accountants, auditors or other insurance companies for whom he has worked.

⁵³Cold-calling on individuals in respect of investments is banned by the Securities and Investment Board's rules under the Financial Services Act 1986

Section 1(iii) is closely related with section 1 (v). Some provisions under the 'General Sales Principles' and 'Accounts and Financial Aspects' may be said to be of a quasi-fiduciary nature. The provisions under 'Explanation of the Contract' and 'Disclosure of Underwriting Information' seem to be related to the question of the standards of skill and care expected. The requirement to explain all the essential provisions of the cover, any restrictions and exclusions is very important, because it will give the proposer a chance to understand what kind of insurance policies he is buying. Undoubtedly, this requirement will be a heavy burden on the intermediary and a difficult burden to meet, considering the fact that many insurance contracts contain the technical nature. Therefore, if necessary, expert advice from the insurance company should be called in.

The provisions as regarding the proposal form are closely related with the Statement of Insurance Practice. The intermediary should explain the importance of full disclosure, and the consequences of non-disclosure should be warned. In other words, the intermediary should make it clear that all the answers or statements are the policyholder's responsibility. In addition, he must avoid influencing the policyholder in completing answers on the form. In practice, he will often be asked for advice, but he must make the policyholder aware that the answers are the policyholder's own responsibility.

In the part II, an intermediary, who is acting merely as an introducer, is required to give advice only to the matters in which he is competent, and he is required to transmit enquiries to the companies as soon as possible, seeking for assistance from the company if necessary. He should not do something beyond the terms of his agency appointment and should not influence the customer in completing the proposal form.

10.4.3. MISCELLANIES

In *Harvest Trading Co. Ltd v. P.B. Davis Services*⁵⁴, the Code was regarded as a self-regulation providing useful guidance as to the standard of care expected of an unregistered intermediary. It is the condition of membership of the A.B.I. that the member companies will undertake the enforcement of the Code. The member companies will see whether the Code is followed by intermediaries who work for them. A duty is also imposed on the member companies to make the consumers aware that this Code exists for them and this Code gives them some protection. There is no doubt that the requirements of the Code will put some onerous burden on the intermediary. Unlike the Statements of Insurance Practice, the A.B.I. has set up a committee responsible for monitoring the working of the Code. In fact, the consumer who has contracted with the companies through an intermediary can be protected more, because if the non-broker intermediary did not follow the Code, the consumer may pursue a legal remedy against him or against the insurance company for whom the intermediary has worked.

The non-broker intermediaries are highly likely to be influenced by the level of commission when they recommend the insurers to the consumers. However, the intermediary's disclosure of the commission which he would receive is not expressly required by the Code.⁵⁵ Although the disclosure can be made by the customer's request, a clear provision requiring the intermediary to disclose the commission is needed. The Code does not require that the proposer himself should fill in the answers. In relation to this issue, the Insurance Ombudsman imposes on the proposer an obligation to read and check the accuracy of a proposal form before signing in the case where the proposal form is completed by an intermediary. If the proposer breaches this duty, the Ombudsman will not ask an insurer to meet a claim unless there is evidence of the

⁵⁴[1991] 2 Lloyd's Rep. 638

⁵⁵Compare, the Financial Services (Conduct of Business) (Product and Commission Disclosure) Rules 1994 under the auspice of the Financial Services Act 1986.

intermediary's mistake.⁵⁶ However, if the intermediary fills in the form, it is not difficult to imagine that many proposers will not actually carefully check and read the accuracy of the form before signing no matter how much it is recommended that the proposers should do so. In addition, the similar criticism as to the effectiveness of self-regulation as the Statements of Insurance Practice can be made here.⁵⁷

10.5. SUMMARY OF SUGGESTIONS - CONCLUSION

There is no doubt that the bargaining power in the making of insurance contracts under the current practice is all on one side - that of the insurers. The insured may be unaware of the existence of the duty of disclosure. The insured may not know under the current test of materiality what is the material fact which he should disclose. The consequences of the breach of the duty of disclosure is too harsh to the insured. The insurer is highly likely to rely on the non-disclosure as a technical defence to a claim where other defences to the claim seem to be difficult to set up or to prove. The balance between the parties should be restored by a more radical reform, and this reform should focus on the attempts to restrict sharply the wide scope of the insured's duty of disclosure. This is the current tendency of other common law jurisdictions such as Canada, the U.S.A. and Australia.

The followings are the summary of suggestions for reform as to the issue of the duty of disclosure in insurance contracts. Firstly, the current test of materiality along with the prudent insurer test should be changed. The alternative could be a reasonable insured test which is adopted in the Insurance Contracts Act 1984 in Australia. This reasonable insured test would reduce the scope of constructive knowledge of the insured, which is still required to be disclosed in English insurance law, unlike in the U.S.A. where a disclosure of known facts is all that is required in non-marine insurance. As to the

⁵⁶Merkin & McGee, A.5.8-03-04

⁵⁷See, sub-chapter 10.2.2.4. of this thesis.

degree of influence in the test of materiality, the decisive influence test should be adopted. It would appear that this decisive influence test can do something to mitigate the harshness of the current all-or-nothing approach in relation to the effect of non-disclosure.

Secondly, the insured's intention to deceive or fraud should be a prerequisite to an insurer's right to avoid the policy for non-disclosure, at least in non-marine insurance cases. This is Lord Mansfield's modified view in England⁵⁸, and adopted in Canada and the U.S.A. where the insurer's proof of the insured's fraud is required to avoid a policy for non-disclosure.⁵⁹

Thirdly, the scope of the duty of disclosure should be differentiated between marine and non-marine insurance considering the fact that the rationale for the marine insurance cases, which makes it understandable, although it is also debatable, that the insured's constructive knowledge is included in the scope of the insured's duty of disclosure in the marine insurance, does not apply to the non-marine insurance cases. In other words, it is too harsh to impose the duty on the insured to disclose the constructive knowledge in the non-marine insurance cases, considering the current position and power of the insurer in the insurance market compared with those of the insured. This distinction has been already adopted in the U.S.A.

Fourthly, where there is a proposal form, the insured's duty of disclosure should be discharged by correctly answering to the lengthy list of questions including a general question, and more residual duty should not be imposed on the insured. In addition, for any matter not requested on the proposal form, the presumption of immateriality should be considered.

⁵⁸*Mayne v. Walter*, quoted in Park, *The Law of Marine Insurance* (1787), at p. 220 ; Also see, *London Assurance v. Mansel* (1879) 11 Ch. D. 363

⁵⁹See, Chapter 2 of this thesis.

Fifthly, the contents of the insurer's duty of disclosure should be substantiated including the important questions of the test of materiality and of awarding damages to the insured for the insurer's breach of his duty in the case where awarding damages seems to be the only effective remedy. Unless the effective contents and remedies are provided, the insurer's duty of disclosure, which is very important in terms of fair dealing and protection of the insured, could be meaningless. As to the test of materiality in the insurer's duty of disclosure, Steyn J.'s test at first instance in Banque Keyser Ullmann S.A. v. Skandia (U.K.) Ins. Co. Ltd.⁶⁰ - a good faith and fair dealing test - seems to be the most convincing test, although some criticism exist. As to the issue of awarding damages to the insured for the insurer's breach of his duty, it would appear that the reasons provided by the higher courts for objection to the remedy of damages are not acceptable. If awarding damages seems to be the only effective remedy to the insured for the insurer's breach of the duty of disclosure, it should be allowed.

Sixthly, the effect of non-disclosure should be reformed. Although the recent decision of the House of Lords in Pan Atlantic Insurance Co. Ltd v. Pine Top Insurance Co. Ltd⁶¹ might go some way to resolving the injustice that has surrounded non-disclosure in insurance contracts by introducing the requirement of actual inducement, this decision did not resolve the unfairness of the right to rescind. The insurer's right to rescind the contract *ab initio* for non-disclosure of material fact is unjust and inappropriate, because it is possible for the insurer to avoid the whole policy for non-disclosure of a fact which may have only a marginal effect on a higher premium. This all-or-nothing consequence of non-disclosure and the *carte blanche* to the avoidance of insurance contracts on the grounds of non-disclosure supported by vague evidence, which might be related with the acceptance of the non-decisive influence test as a test of materiality, should be reformed. A better view seems to be a proportionality principle, although there are criticism as to

⁶⁰[1987] 1 Lloyd's Rep. 69

⁶¹[1994] 3 W.L.R. 677

this principle. Some method of calculation which is not overly mathematical and not unworkable could be devised by detailed underwriting guides.⁶² This principle was adopted as an alternative to the current practice in the Annual Report of Insurance Ombudsman Bureau in 1989 and 1990. Where the insured has not been fraudulent and the loss was not causally connected to the information misstated or withheld, a proportionate award to the insured should be allowed after considering an adjustment in the premium and in the amount of the cover, on the condition that if the insurer had been aware of the non-disclosed fact, the insurer would not have declined the risk, but would have only increased the premium. Likewise, in relation to operation of this proportionality principle, the insurer is required to prove, in order to avoid this principle, that he would have declined the risk if he had been told the non-disclosed fact. It would appear that this is a fairer and more reasonable approach, despite some criticisms.

Seventhly, the application and interpretation of the presumption of inducement in relation to the requirement of the actual inducement in non-disclosure should be made with extra caution. Inducement cannot be inferred in law from proved materiality. It should be a presumption of fact, not a presumption of law. Therefore, the court is not obliged to draw the presumption of inducement as a matter of law. In general, the insurer should prove inducement. Presumption will be only applied in which the underwriter cannot (for good reason) give evidence and there is no reason to suppose that the actual underwriter acted other than prudently in writing the risk. The presumption of inducement should be a last resort. In other words, the presumption of inducement should be narrowly and limitedly applied in practice.

Lastly, a special organization for monitoring the insurers' compliance with the Statements of Practice is needed and the sanction for non-compliance should be changed with a real effect in order to overcome its own weakness which is due to the nature of self-regulation itself. In addition, both entering into membership of the A.B.I. and

⁶²V. Cowan, "Non-disclosure - a more equitable solution?" 4 Insurance Law & Practice (1994, No.1) 20, at p. 21

compliance with the Statements of Practice should be a prerequisite to transacting insurance business.⁶³ The contents of the Statements of Practice should be also reformed again for more effective protection of the insured, including the provisions which will control the making terms and policies in terms of fairness. Of course, a statutory reform of non-disclosure in insurance contracts should be now seriously considered, because the proper legislation could be the most effective way to protect the insured. In addition, activities of conciliation and arbitration services such as the Insurance Ombudsman Bureau as an initial way to resolve the disputes should be further developed, and more effective power and authority should be given to them.

In conclusion, the law of the duty of disclosure has been shown to be defective, and should, therefore, be properly reformed in terms of the protection of the insured.

⁶³The motor insurers should be members of Motor Insurers Bureau Ltd.

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The Statement of General Insurance Practice (1986)

The Statement of Long-Term Insurance Practice (1986)

The Insurance Ombudsman Annual Report (1989-1994)

Association of British Insurers' General Insurance Business Code of Practice for All Intermediaries (Including Employees of Insurance Companies) Other Than Registered Insurance Brokers.

CODES OF PRACTICE

8.901 STATEMENT OF GENERAL INSURANCE PRACTICE

The following statement of normal insurance practice, issued by the Association of British Insurers, applies to general insurances of policyholders resident in the UK and insured in their private capacity only.

1. Proposal forms

(a) The declaration at the foot of the proposal form should be restricted to completion according to the proposer's knowledge and belief.

(b) Neither the proposal form nor the policy shall contain any provision converting the statements as to past or present fact in the proposal form into warranties. But insurers may require specific warranties about matters which are material to the risk.

(c) If not included in the declaration, prominently displayed on the proposal form should be a statement:

(i) drawing the attention of the proposer to the consequences of the failure to disclose all material facts, explained as those facts an insurer would regard as likely to influence the acceptance and assessment of the proposal;

(ii) warning that if the proposer is in any doubt about facts considered material, he should disclose them.

(d) Those matters which insurers have found generally to be material will be the subject of clear questions in proposal forms.

(e) So far as is practicable, insurers will avoid asking questions which would require expert knowledge beyond that which the proposer could reasonably be expected to possess or obtain or which would require a value judgment on the part of the proposer.

(f) Unless the prospectus or the proposal form contains full details of the standard cover offered, and whether or not it contains an outline of that cover, the proposal form shall include a prominent statement that a specimen copy of the policy form is available on request.

(g) Proposal forms shall contain a prominent warning that the proposer should keep a record (including copies of letters) of all information supplied to the insurer for the purpose of entering into the contract.

(h) The proposal form shall contain a prominent statement that a copy of the completed form:

(i) is automatically provided for retention at the time of completion; or

(ii) will be supplied as part of the insurer's normal practice; or

(iii) will be supplied on request within a period of three months after its completion.

(i) An insurer shall not raise an issue under the proposal form, unless the policyholder is provided with a copy of the completed form.

2. Claims

(a) Under the conditions regarding notification of a claim, the policyholder shall not be asked to do more than report a claim and subsequent developments as soon as reasonably possible except in the case of legal processes and claims which a

third party requires the policyholder to notify within a fixed time where immediate advice may be required.

(b) An insurer will not repudiate liability to indemnify a policyholder:

- (i) on grounds of non-disclosure of a material fact which a policyholder could not reasonably be expected to have disclosed;
- (ii) on grounds of misrepresentation unless it is a deliberate or negligent misrepresentation of a material fact;
- (iii) on grounds of a breach of warranty or condition where the circumstances of the loss are unconnected with the breach unless fraud is involved.

Paragraph 2(b) above does apply to marine and aviation policies.

(c) Liability under the policy having been established and the amount payable by the insurer agreed, payment will be made without avoidable delay.

3. Renewals

(a) Renewal notices should contain a warning about the duty of disclosure including the necessity to advise changes affecting the policy which have occurred since the policy inception or last renewal date, whichever was the later.

(b) Renewal notices shall contain a warning that the proposer should keep a record (including copies of letters) of all information supplied to the insurer for the purposes of renewal of the contract.

4. Commencement

Any changes to insurance documents will be made as and when they need to be reprinted, but the Statement will apply in the meantime.

5. Policy documents

Insurers will continue to develop clearer and more explicit proposal forms and policy documents whilst bearing in mind the legal nature of insurance contracts.

6. Disputes

The provisions of the Statement shall be taken into account in arbitration and any other referral procedures which may apply in the event of disputes between policyholders and insurers relating to matters dealt with in the Statement.

7. EEC

This Statement will need reconsideration when the draft EEC Directive on Insurance Contract Law is adopted and implemented in the United Kingdom.

8.902 STATEMENT OF LONG-TERM INSURANCE PRACTICE

This statement relates to long-term insurance effected by individuals resident in the UK in a private capacity.

1. Proposal forms

(a) If the proposal form calls for the disclosure of material facts a statement should be included in the declaration, or prominently displayed elsewhere on the form or in the document of which it forms part:

- (i) drawing attention to the consequences of failure to disclose all material facts and explaining that these are facts that an insurer would regard as likely to influence the assessment and acceptance of a proposal;
- (ii) warning that if the signatory is in any doubt about whether certain facts are material, these facts should be disclosed.

(b) Neither the proposal nor the policy shall contain any provision converting the statements as to past or present fact in the proposal form into warranties except where the warranty relates to a statement of fact concerning the life to be assured under a life of another policy. Insurers may, however, require specific warranties about matters which are material to the risk.

(c) Those matters which insurers have commonly found to be material should be the subject of clear questions in proposal forms.

(d) Insurers should avoid asking questions which would require knowledge beyond that which the signatory could reasonably be expected to possess.

(e) The proposal form or a supporting document should include a statement that a copy of the policy form or of the policy conditions is available on request.

(f) The proposal form or a supporting document should include a statement that a copy of the completed proposal form is available on request.

2. Policies and accompanying documents

(a) Insurers will continue to develop clearer and more explicit proposal forms and policy documents whilst bearing in mind the legal nature of insurance contracts.

(b) Life assurance policies or accompanying documents should indicate:

- (i) the circumstances in which interest would accrue after the assurance has matured; and
- (ii) whether or not there are rights to surrender values in the contract and, if so, what those rights are.

(Note: The appropriate sales literature should endeavour to impress on proposers that a whole life or endowment assurance is intended to be a long-term contract and that surrender values, especially in the early years, are frequently less than the total premiums paid.)

3. Claims

(a) An insurer will not unreasonably reject a claim. In particular, an insurer will not reject a claim or invalidate a policy on grounds of non-disclosure or misrepresentation of a fact unless:

- (i) it is material fact; and
- (ii) it is a fact within the knowledge of the proposer; and
- (iii) it is a fact which the proposer could reasonably be expected to disclose.

(It should be noted that fraud or deception will, and reckless or negligent non-disclosure or misrepresentation of a material fact may, constitute grounds for rejection of a claim.)

(b) Except where fraud is involved, an insurer will not reject a claim or invalidate a

policy on grounds of a breach of a warranty unless the circumstances of the claim are connected with the breach and unless:

- (i) the warranty relates to a statement of fact concerning the life to be assured under a life of another policy and that statement would have constituted grounds for rejection of a claim by the insurer under 3(a) above if it had been made by the life to be assured under an own life policy; or
 - (ii) the warranty was created in relation to specific matters material to the risk and it was drawn to the proposer's attention at or before the making of the contract.
- (c) Under any conditions regarding a time limit for notification of a claim, the claimant will not be asked to do more than report a claim and subsequent developments as soon as reasonably possible.
- (d) Payment of claims will be made without avoidable delay once the insured event has been proved and the entitlement of the claimant to receive payment has been established.
- (e) When the payment of a claim is delayed more than two months, the insurer will pay interest on the cash sum due, or make an equivalent adjustment to the sum, unless the amount of such interest would be trivial. The two month period will run from the date of the happening of the insured event (i.e. death or maturity) or, in the case of a unit linked policy, from the date on which the unit linking ceased, if later. Interest will be calculated at a relevant market rate from the end of the two month period until the actual date of payment.
- (f) In the case of a tax exempt policy with a friendly society, the total of the cash sum due and such interest to the date of the claim cannot exceed the statutory limit on such assurance.

4. Disputes

The provisions of the Statement shall be taken into account in arbitration and any other referral procedures which may apply in the event of disputes between policyholders and insurers relating to matters dealt with in the Statement.

5. Commencement

Any changes to insurance documents will be made as and when they need to be reprinted, but the Statement will apply in the meantime.

Note regarding industrial assurance policyholders

Policies effected by industrial assurance policyholders are included amongst the policies to which the above Statement of Long-Term Insurance Practice applies. Those policyholders also enjoy the additional protection conferred upon them by the Industrial Assurance Acts 1923 to 1969 and Regulations issued thereunder. These Acts give the Industrial Assurance Commissioner wide powers to cover inter alia the following aspects:

- (a) Completion of proposal forms.
- (b) Issue and maintenance of premium receipt books.
- (c) Notification in premium receipt books of certain statutory rights of a policyholder including rights to:
 - (i) an arrears notice before forfeiture;
 - (ii) free policies and surrender values for certain categories of policies;
 - (iii) relief from forfeiture of benefit under a policy on health grounds unless the proposer has made an untrue statement of knowledge and belief as to the assured's health;

- (iv) reference to the Commissioner as arbitrator in disputes between the policyholder and the company or society.

The offices transacting industrial assurance business have further agreed that any premium (or deposit) paid on completion of the proposal form will be returned to the proposer if, on issue, the policy document is rejected by him or her.

CODES OF CONDUCT

3.701 ASSOCIATION OF BRITISH INSURERS' GENERAL INSURANCE BUSINESS CODE OF PRACTICE FOR ALL INTERMEDIARIES (INCLUDING EMPLOYEES OF INSURANCE COMPANIES) OTHER THAN REGISTERED INSURANCE BROKERS

Introduced January 1989 (replacing earlier versions)

This code applies to general business as defined in the Insurance Companies Act 1982, but does not apply to reinsurance business. As a condition of membership of the Association of British Insurers, members undertake to enforce this code and to use their best endeavours to ensure that all those involved in selling their policies observe its provisions.

It shall be an overriding obligation of an intermediary at all times to conduct business with the utmost good faith and integrity.

In the case of complaints from policyholders (either direct or indirect, e.g. through a trading standards officer or citizens advice bureau) the insurance company concerned shall require an intermediary to co-operate so that the facts can be established. An intermediary shall inform the policyholder complaining that he can take his problem direct to the insurance company concerned.

PART I

A. General sales principles

1. The intermediary shall:
 - (i) where appropriate make a prior appointment to call. Unsolicited or unarranged calls shall be made at an hour likely to be suitable to the prospective policyholder;
 - (ii) when he makes contact with the prospective policyholder, identify himself and explain as soon as possible that the arrangements he wishes to discuss could include insurance. He shall make it known that he is:
 - (a) an employee of an insurance company, for whose conduct the company accepts responsibility;
 - (b) an agent of one company for whose conduct the company accepts responsibility;
 - (c) an agent of two or up to six companies, for whose conduct the companies accept responsibility; or
 - (d) an independent intermediary seeking to act on behalf of the prospective policyholder, for whose conduct the company/companies do not accept responsibility;
 - (iii) ensure as far as possible that the policy proposed is suitable to the needs and resources of the prospective policyholder;
 - (iv) give advice only on those insurance matters in which he is knowledgeable and seek or recommend other specialist advice when necessary; and
 - (v) treat all information supplied by the prospective policyholder as completely confidential to himself and to the company or companies to which the business is being offered.

2. The intermediary shall not:

- (i) inform the prospective policyholder that his name has been given by another person unless he is prepared to disclose that person's name if requested to do so by the prospective policyholder and has that person's consent to make that disclosure;
- (ii) make inaccurate or unfair criticisms of any insurer; or
- (iii) make comparisons with other types of policies unless he makes clear the differing characteristics of each policy.

B. Explanation of the contract

The intermediary shall:

- (i) identify the insurance company;
- (ii) explain all the essential provisions of the cover afforded by the policy, or policies, which he is recommending so as to ensure as far as possible that the prospective policyholder understands what he is buying;
- (iii) draw attention to any restrictions and exclusions applying to the policy;
- (iv) if necessary, obtain from the insurance company specialist advice in relation to items (ii) and (iii) above;
- (v) not impose any charge in addition to the premium required by the insurance company without disclosing the amount and purpose of such charge; and
- (vi) if he is an independent intermediary, disclose his commission on request.

C. Disclosure of underwriting information

The intermediary shall, in obtaining the completion of the proposal form or any other material:

- (i) avoid influencing the prospective policyholder and make it clear that all the answers or statements are the latter's own responsibility; and
- (ii) ensure that the consequences of non-disclosure and inaccuracies are pointed out to the prospective policyholder by drawing his attention to the relevant statement in the proposal form and by explaining them himself to the prospective policyholder.

D. Accounts and financial aspects

The intermediary shall, if authorised to collect monies in accordance with the terms of his agency appointment:

- (i) keep a proper account of all financial transactions with a prospective policyholder which involve the transmission of money in respect of insurance;
- (ii) acknowledge receipt (which, unless the intermediary has been otherwise authorised by the insurance company, shall be on his own behalf) of all money received in connection with an insurance policy and shall distinguish the premium from any other payment included in the money; and
- (iii) remit any such monies so collected in strict conformity with his agency appointment.

E. Documentation

The intermediary shall not withhold from the policyholder any written evidence or documentation relating to the contract of insurance.

F. Existing policyholders

The intermediary shall abide by the principles set out in this code to the extent that they are relevant to his dealings with existing policyholders.

G. Claims

If the policyholder advises the intermediary of an incident which might give rise to a claim, the intermediary shall inform the company without delay, and in any event within three working days, and thereafter give prompt advice to the policyholder of the company's requirements concerning the claim, including the provision as soon as possible of information required to establish the nature and extent of the loss. Information received from the policyholder shall be passed to the company without delay.

H. Professional indemnity cover for independent intermediaries

The intermediary shall obtain, and maintain in force, professional indemnity insurance in accordance with the requirements of the Association of British Insurers as set out in the Annex, which may be updated from time to time.

I. Letters of appointment

This code of practice shall be incorporated verbatim or by reference in all letters of appointment of non-registered intermediaries and no policy of the company shall be sold by such intermediaries except within the terms of such a letter of appointment.

ANNEX**Code of Practice for the Selling of General Insurance****Professional Indemnity Cover Required for Non-Registered Independent Intermediaries**

As from 1st January 1989 (new agents) and by 1st July 1989 (existing agents) all non-registered independent intermediaries must take out and maintain in force professional indemnity cover in accordance with the requirements set out below.

The insurance may be taken out with any authorised UK or EC insurer who has agreed to:

- (a) issue cover in accordance with the requirements set out below;
- (b) provide the intermediary with an annual certificate as evidence that the cover meets the ABI requirements, this certificate to contain the name and address including postcode of the intermediary, the policy number, the period of the policy, the limit of indemnity, the self insured excess and the name of the insurer;
- (c) send a duplicate certificate to ABI at the time the certificate is issued to the intermediary;
- (d) inform ABI, by means of monthly lists, of any cases of non-renewal, cancellation of the cover mid-term or of the cover becoming inadequate.

The requirements are as follows:

A. Limits of Indemnity

The policy shall at inception and at each renewal date, which shall not be more than 12 months from inception or the last renewal date, provide a minimum limit of indemnity of either:

- (a) a sum equal to three times the annual general business commission of the business for the last accounting period ending prior to inception or renewal of the policy, or a sum of £250,000, whichever sum is the greater.

In no case shall the minimum limit of indemnity be required to exceed £5m, and a minimum sum of £250,000 shall apply at all times to each and every claim or series of claims arising out of the same occurrence; or

- (b) a sum equal to three times the annual general business commission of the business for the last accounting period ending prior to inception or renewal of the policy, or a sum of £500,000 whichever sum shall be the greater.
- In no case shall the minimum limit of indemnity be required to exceed £5m.

B. Maximum Self-insured Excess

The maximum self-insured excess permitted in normal circumstances shall be 1% of the minimum limit of indemnity required by Paragraph A(a) or A(b) above as the case may be. Subject to the agreement of the professional indemnity insurer, the self-insured excess may be increased to a maximum of 2% of such minimum limit of indemnity.

C. Scope of Policy Cover

The policy shall indemnify the insured:

- (a) against losses arising from claims made against the insured:
 - (i) for breach of duty in connection with the business by reason of any negligent act, error or omission; and
 - (ii) in respect of libel or slander or in Scotland defamation, committed in the conduct of the business by the insured, any employee or former employee of the insured, and where the business is or was carried on in partnership any partner or former partner of the insured; and
 - (iii) by reason of any dishonest or fraudulent act or omission committed or made in the conduct of the business by any employee (other than a director of a body corporate) or former employee (other than a director of a body corporate) of the insured; and
- (b) against claims arising in connection with the business in respect of:
 - (i) any loss of money or other property whatsoever belonging to the insured or for which the insured is legally liable to consequence of any dishonest or fraudulent act or omission of any employee (other than a director of a body corporate) or former employee (other than a director of a body corporate) of the insured; and
 - (ii) legal liability incurred by reason of loss of documents and costs and expenses incurred in replacing or restoring such documents.

D. General Business Only

The above requirements relate only to the intermediary's general insurance business.

